TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, [redacted] 1926

No. [redacted] 73

Fred A. Miller and Elise K. Joy, executors of the Estate of ERNEST G. MILLER, deceased, PLAINTIFFS IN ERROR,

vs.

THE CITY OF MILWAUKEE

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF WISCONSIN

FILED APRIL 20, 1925

(31,055)

(31.055)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1925

No. 370

ERNEST G. MILLER, PLAINTIFF IN ERROR,

vs.

THE CITY OF MILWAUKEE

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF WISCONSIN

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., AUGUST 28, 1925

50229

[fol. 1] [Caption omitted]

[fol. 2] **IN UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WISCONSIN**

ERNEST G. MILLER, Plaintiff,

vs.

CITY OF MILWAUKEE, a Municipal Corporation, Defendant

BILL OF COMPLAINT—Filed June 6, 1924

The plaintiff, by A. W. Schutz, his attorney, complains of the defendant and for cause of action alleges:

I

That at all times herein mentioned, the plaintiff was and still is a citizen of the United States and of the State of Wisconsin, resident in the City and County of Milwaukee, in the Eastern District in said State, and as a shareholder in the corporations to which reference is hereinafter made, had and received the cash and stock dividends in controversy in this action.

II

That at all times herein mentioned, the defendant, City of Milwaukee, was and still is a municipal corporation, duly organized and existing under and by virtue of the laws of the State of Wisconsin, located in the Eastern District of said State.

III

That on or about the 26th day of July, A. D. 1923, the plaintiff [fol. 3] received notice from the Assessor of Income of the Tenth District of the State of Wisconsin, that said Assessor had, under and in pursuance of Chapter 71 of the Wisconsin Statutes, made the increase in the assessment of his income for the year 1922, forming the subject of this action, the nature and amount of which is hereinafter fully set forth in connection with the proceedings thereafter had and taken.

IV

That on the 12th day of October, 1923, the plaintiff duly filed with the Milwaukee County Board of Review of Income Tax Assessments, the complaint and specification of objections to said increase in the assessment of his income for the year 1922, made by said Assessor of Incomes, in the aggregate sum of $114,252.00, copy of which is

hereto attached and marked Exhibit "A", and made a part hereof with the same force and effect as if repeated at length.

V

That as more fully appears from said Exhibit, said sum is made up in the aggregate of cash and stock dividends which were directly declared from interest accruing on securities issued under and by virtue of the Constitution of the United States, and the Acts of Congress enacted in pursuance thereof, particularly set forth in said Exhibit.

VI

That a hearing was duly had before said board, under and pursuant to the provisions of Section 71.13 of the Wisconsin Statutes, testimony taken and a stipulation of facts by and between the plaintiff and the Assessor of Incomes of said assessment district, duly [fol. 4] filed and received by the said board, copy of which is hereto attached and marked Exhibit "B", and made a part hereof with the same force and effect as if repeated at length; that after full disclosure having been made under oath of any and all income of plaintiff liable to assessment, said board did, by resolution duly adopted, lessen said assessment in said aggregate sum of $114,252.00 as shown by notice thereof hereto attached and marked Exhibit "C", and made a part hereof with the same force and effect as if repeated at length.

VII

That thereafter the said Assessor of Incomes appealed from the determination of said Milwaukee County Board of Review of Income Tax Assessments to the Tax Commission of Wisconsin, which last named body, did on the 22nd day of December, 1923, reverse said determination of said County Board of Review and directed the clerk of said County of Milwaukee to restore said objectionable assessment in the said sum of $114,252.00, notice of which order is hereto attached and marked Exhibit "D" and made a part hereof with the same force and effect as if repeated at length; that the tax levied upon such illegal excess assessment is in the sum of $9,368.67.

VIII

That on the 30th day of January, A. D. 1924, the plaintiff did pay to the Treasurer of the City of Milwaukee, the sum of $11,185.87 in payment of the income tax levied upon him by the State of Wisconsin for the year 1922, and did then and there duly protest that such income tax, so far as it purported to be levied on income in excess of $28,412.00, to-wit: said sum of $9,368.67, was [fol. 5] improperly and illegally assessed and levied; that thereafter, to-wit, on the 19th day of February, A. D. 1924, the plaintiff did, under and in pursuance of the provisions of Section 74.73 of the

Wisconsin Statutes, file a claim for the refund of said sum of $9,368.67 against said City of Milwaukee but that said claim was, on the 26th day of May, A. D. 1924, by it disallowed.

IX

That said income in said sum of $114,252.00 was assessed to the plaintiff in contravention of the Acts of Congress passed April 24th, 1917, and September 24th, 1917, as amended and Article XIV of the Amendments to the Constitution of the United States.

Wherefore, plaintiff demands judgment against the defendant in the sum of $9,368.67, together with the costs and disbursements of this action, and lawful interest.

A. W. Schutz, Attorney for Plaintiff.

[fol. 6] EXHIBIT "A" TO BILL OF COMPLAINT

BEFORE THE MILWAUKEE COUNTY BOARD OF REVIEW OF INCOME TAX ASSESSMENTS

In the Matter of the Assessment of the Income of ERNEST G. MILLER, Return Numbered 2309

Ernest G. Miller, by A. W. Schutz, his attorney, herein and hereby respectfully makes complaint against the increase in assessment of his income made by the Assessor of Incomes of the Tenth District of the State of Wisconsin, in the aggregate sum of $114,252.00, upon the grounds hereinafter specified, reference being had to the Assessor's notice of increase of assessment dated July 26th, 1923.

1. Fred Miller Heirs, Incorporated:

Cash and stock dividends of this corporation to the aggregate amount of $135,200.00 are therein scheduled. A deduction of $118,083.68 therefrom is therein allowed, being sum upon which tax was paid by mentioned corporation; the difference, to-wit; $17,116.32 is assessed to claimant, but this sum consists of that portion of the mentioned dividends which were directly declared from interest accruing from United States Bonds issued under and by virtue of the Acts of Congress passed April 24th, 1917, and September 24th, 1917, and as such, not subject to assessment under Chapter 71 of the Wisconsin Statutes.

Complainant, therefore, objects to the inclusion in the mentioned assessment of said sum of..... $17,116.32

2. Oriental Investment Company:

Stock dividends of this corporation to the aggregate amount of $128,000.00 are therein scheduled. A deduction of $81,254.40

therefrom is therein allowed, being sum upon which tax was paid by mentioned corporation; the difference, to-wit; $46,745.60 is assessed to complainant, but this sum consists to the amount of $27,524.13 of that portion of the mentioned dividends which were directly declared from interest accruing from United States bonds [fol. 7] issued under and by virtue of the Acts of Congress passed April 24th, 1917, and September 24th, 1917, and as such, are not subject to assessment under Chapter 71 of the Wisconsin Statutes.

Complainant, therefore, objects to the inclusion in the mentioned assessment as derived from Federal tax exempt securities of the sum of..... $27,524.13

3. Fred Miller Brewing Company:

Stock dividends of this corporation to the aggregate amount of $121,000.00 are therein scheduled. A deduction of $46,609.20 therefrom is therein allowed, being sum upon which tax was paid by mentioned corporation; the difference, to-wit; $74,390.80 is assessed to complainant, but this sum consists to the amount of $69,611.55 of that portion of the mentioned dividends which were directly declared from interest accruing from United States Bonds issued under and by virtue of the Acts of Congress passed April 24th, 1917, and September 24th, 1917, and as such, not subject to assessment under Chapter 71 of the Wisconsin Statutes.

Complainant, therefore objects to the inclusion in the mentioned assessment as derived from Federal tax exempt securities of the sum of..... 69,611.55

Wherefore, complainant accordingly makes request that your Honorable Body lessen the amount of the income assessment in the aggregate sum hereinbefore specified, to-wit; $114,252.00, being that portion of the foregoing dividends declared out of interest accruing from Federal tax exempt securities.

A. W. Schutz, Complainant's Attorney.

Summary Statement

Name of corporation	Total dividends	Deduction allowed	Amount assessed	Deduction claimed
Fred Miller Heirs.....	$135,200.00	$118,083.68	$17,116.32	$17,116.32
Oriental Invest. Co.....	128,000.00	81,254.40	46,745.60	27,524.13
Fred Miller Brw. Co.....	121,000.00	46,609.20	74,390.80	69,611.55
Total	$384,200.00	$245,947.28	$138,252.72	$114,252.00

[fol. 8] EXHIBIT "B" TO BILL OF COMPLAINT

BEFORE THE MILWAUKEE COUNTY BOARD OF REVIEW OF INCOME TAX ASSESSMENTS

In the Matter of the Assessment of the Income of ERNEST G. MILLER, Return Numbered 2309

Stipulation

It is herein and hereby expressly stipulated and agreed by and between Ernest G. Miller, by A. W. Schutz, his attorney, and J. H. Leenhouts, Assessor of Incomes of the Tenth District of the State of Wisconsin, that the recital of facts in the complaint and specification of objections to increase of income tax assessment filed by complainant herein, is a correct statement thereof, except that the said Assessor denied any and all allegations setting forth that such portion of corporate dividends derived from Federal tax exempt securities of the Corporations therein mentioned, are not subject to assessment under Chapter 71 of the Wisconsin Statutes.

A. W. Schutz, Complainant's Attorney. J. H. Leenhouts, Assessor of Incomes.

[fols. 9-13] EXHIBIT "C" TO BILL OF COMPLAINT.

County of Milwaukee, Office of the County Clerk, Court House

Milwaukee, Wis., Nov. 6, 1923.

Mr. Ernest G. Miller, 3200 Highland Blvd., Milwaukee, Wis.

DEAR SIR: As Clerk of the Income Tax Board of Review of Milwaukee County, I herewith wish to inform you that I have been instructed by said board to notify you that they passed the following resolution:

Resolved: That the assessment against Ernest G. Miller, by the Assessment of Incomes, in the amount of $142,664.00, be and the same is hereby amended, fixed and confirmed in the sum of $28,412.30.

Yours truly, Wm. J. Cary, County Clerk and Clerk of the Income Tax Board of Review.

EXHIBIT "D" TO BILL OF COMPLAINT

County of Milwaukee, Office of the County Clerk, Court House

Milwaukee, Wis., Dec. 28, 1923.

Mr. Ernest G. Miller, 3200 Highland Blvd., Milwaukee, Wis.

DEAR SIR: As Clerk of the Income Tax Board of Review of Milwaukee County, I herewith wish to notify you that I have received an order from the Wisconsin Tax Commission in the matter of the appeals of John H. Leenhouts, Assessor of Incomes, Milwaukee County, whereby the assessment of $28,412.00 is amended, fixed, confirmed and changed by the order of said commission to the sum of $142,664.00.

Dated this 28th day of December, A. D. 1923.

Yours very truly, Wm. J. Cary, County Clerk and Clerk of the Income Tax Board of Review.

[File endorsement omitted.]

[fol. 14] IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION RE FACTS—Filed Nov. 20, 1924

It is hereby stipulated and agreed by and between the parties in the above entitled action, by their respective attorneys, that the facts in the above entitled action are as set forth in the complaint on file herein, as hereinafter amended, and with the exception that paragraph numbered V of the complaint shall be deemed amended to read as follows:

"That as more fully appears from said exhibit, said sum is made up in the aggregate of cash and stock dividends which were directly declared from surplus of the corporations aforesaid, which surplus to the amount and extent of said sum consisted of earnings wholly made out of interest accruing on securities issued under and by virtue of the Constitution of the United States and the Acts of Congress enacted in pursuance thereof, more particularly set forth in said exhibit."

[fol. 15] Upon the foregoing stipulation of facts both parties hereby submit the issue so made in the above entitled action to the determination of the Court.

(Signed) A. W. Schutz, Plaintiff's Attorney. W. J. Mattison, Assistant City Attorney, Attorney for Defendant.

[File endorsement omitted.]

[fol. 16] IN UNITED STATES DISTRICT COURT

[Title omitted]

MEMORANDUM OPINION—Filed Jan. 5, 1925

Plaintiff brought this action to recover income taxes paid by him under protest to the City of Milwaukee.

The facts are stipulated.

Plaintiff is a stockholder in Wisconsin corporations owing tax exempt Federal securities, received cash and stock dividends from these corporations. Earnings from the tax exempt securities held by the corporation were credited by such corporations to the surplus, and it was later that plaintiff received his proportionate share thereof through dividends. The corporations did not pay a tax upon the earnings from such tax exempt securities, and plaintiff presents an interesting question arising out of the transfer of such earnings to him in the form of dividends, stock or cash.

Plaintiff's contentions are, (a) stock dividends are not taxable under the income tax law; and (b) Federal courts are required to construe any income tax law as the Supreme Court construed the [fol. 17] Federal income tax law in Pollock v. Farmers' Loan & Trust Co., 167 U. S. 429.

Stock Dividends

Plaintiff relies upon Eisner v. Macomber, 252 U. S. 189, while defendant cites State ex rel. Dulaney v. Nygaard, 174 Wis. 597. In support of this last citation, see Tax Commission v. Putman, 227 Mass. 522; People v. Glynn, 198 N. Y. 605.

That these cases may be somewhat reconciled is suggested by Justice Pitney. When referring to the Massachusetts decision, he says:

"The Massachusetts court was not under any obligation, like the one which binds us, of applying a Constitutional amendment in the light of other Constitutional provisions that stand in the way extending it by construction."

He also says:

"The sixteenth amendment must be construed in connection with the taxing clauses of the original Constitution and the effect attributed to them before the amendment was adopted. In Pollock v. Farmers' Loan & Trust Co., 158 U. S. 601, * * * it was held that taxes upon rents and profits of real estate and upon returns from investments of personal property were in effect direct taxes upon the property from which such income arose, imposed by reason of ownership; and that Congress could not impose such taxes without apportioning them among the States according to population * * *

"Afterwards, and evidently in recognition of the limitation upon the taxing power of Congress thus determined, the Sixteenth Amend-

ment was adopted, in words lucidly expressing the object to be accomplished: 'The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.' As repeatedly held, this did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the States of taxes laid on income."

This court is constrained to accept the decision of the Wisconsin Supreme Court construing and upholding this tax legislation. Des Moines Bank v. Fairweather, 263 U. S. 103, 105.

[fol. 18] Plaintiff's urge, therefore, that the tax on stock dividends is void because not income within the meaning of the Wisconsin statute and constitution, must be rejected.

[fol. 19] Plaintiff's second contention, and the one more elaborately argued, is that stock dividends to the extent and proportion that they have been declared out of interest accruing from Federal securities, are subject to Federal interpretation as to the inherent nature of such dividends when challenged upon a Federal ground, and when so interpreted, the state tax in question does violence to the Fourteenth Amendment to the Federal Constitution.

There is no question but what Subdivision 5 of Section 71.03 of the Revised Statutes of Wisconsin, authorizes the levy the tax in question. The exception which reads:

"Provided that when only part of the income of the corporations * * * from which such dividend or income was received shall have been assessed under this act, only a corresponding part of such dividend or income shall be deducted,"

covers the instant case.

Does this section contravene the Fourteenth Amendment, is the precise question.

Assuming that stock dividends declared out of interest accruing from tax exempt securities are subject to Federal interpretation as to their inherent nature, it by no means follows that the Wisconsin statute is invalid. In the hands of the corporation such property and the income thereof may well be protected by the Federal constitution. But plaintiff's status as the holder of cash or stock dividends received from the corporation is entirely different. Des Moines National Bank v. Fairweather, 263 U. S. 103.

In this case the stock of a national bank was assessed to the [fol. 20] holders thereof. Among the bank's assets were various securities of the United States, concededly exempt from state taxes. Likewise, there was stock in a Federal Reserve Bank. Speaking of these tax exempt securities, the court said:

"It is quite true that the States may not tax such securities, but equally true that they may tax the shares in a corporation to their owners, the stockholders, although the corporate assets consist largely of such securities, and that in assessing the shares it is not necessary

to deduct what is invested in the securities. The difference turns on the distinction between the corporate assets and the shares—the one belonging to the corporation as an artificial entity and the other to the stockholders". * * * "The tax on the shares is not a tax on the capital of the bank." * * *

"The interest of the shareholder entitled him to participate in the net profits earned by the bank in the employment of its capital, during the existence of its charter, in proportion to the number of his shares; and, upon its dissolution or termination, to his proportion of the property that may remain of the corporation after the payment of its debts. This is a distinct independent interest or property, held by the shareholder like any other property that may belong to him. Now, it is this interest which the act of Congress has left subject to taxation by the State, under the limitations prescribed, as will be seen on referring to it."

So property received in the way of a dividend (cash or stock) may be subject to state taxation in a manner different from the earnings in the hands of the corporation. It may be that all of the earnings of the corporations are from tax exempt securities. None could be taxed while in the possession of the corporation, nor could the income thereof be subject to a tax against the corporation. But the same revenue, when paid as a dividend to the stockholder, assumes a different status.

There is no conflict between the state and the Federal Courts as to what is a dividend (cash or stock). If controversy exists, it arises out of differences of opinion respecting the character of stock dividends. More accurately, it might be stated that the different con- [fol. 21] clusions arise out of the construction of the word "income" used in connection with other language.

There has not been any conflict as to the effect of a dividend. When declared, it passed to the stockholder. His dividend, be it stock or cash, was something different from his interest in the corporation prior to the issuance of such dividend. Des Moines National Bank v. Fairweather, supra. In that shift of positions, the income of the corporation lost its exempt character.

This conclusion is confirmed when we view the question from a practical standpoint. Let us assume a hyothetical situation and see to what absurd positions a different conclusion would take us. If A, a stockholder in a large company dealing entirely in tax exempt securities, obtained a dividend and invested it in a building, supplying no other money, would the exemption attach to the income from the building? Obviously not. If two transfers of tax exempt income eliminates the exemption feature, why would not one transfer accomplish the same result? Is the tax exempt feature a covenant that runs with the income? No.

It follows from what has been said that the plaintiff has no cause of action, and the clerk must enter a judgment dismissing his complaint. Let judgment be so entered.

Evan A. Evans, Acting District Judge.

[File endorsement omitted.]

[fol. 22-21] IN UNITED STATES DISTRICT COURT

[Title omitted]

Before Honorable Evan A. Evans, Judge

JUDGMENT—Filed Jan. 9, 1925

The above entitled action having come on for trial before the Court pursuant to a stipulation in writing waiving a jury, and the Court having filed its decision on January 5, 1925, directing judgment dismissing the complaint.

Now, therefore, it is considered and adjudged by this Court that the plaintiff take nothing by his suit, and that the complaint herein be, and the same hereby is dismissed, and that the defendant, City of Milwaukee, do have and recover of the plaintiff, Ernest G. Miller, the sum of Ten Dollars ($10.00) costs, as taxed by the Clerk, and that it have execution therefor.

By the Court.

(Signed) F. C. Westfahl, Jr., Clerk.

[File endorsement omitted.]

[fol. 25] IN UNITED STATES DISTRICT COURT

[Title omitted]

ASSIGNMENT OF ERRORS—Filed March 24, 1925

The plaintiff in this action, in connection with his petition for writ of error, makes the following assignments of error which he avers occurred on the trial thereof and upon which he relies to reverse the judgment herein as appears of record:

1. That the Court erred in directing judgment for dismissal of the complaint upon the agreed statement of facts.

2. That the Court erred in failing to hold that, so far as the dividends in controversy, whether cash or stock, are concerned, to the extent and proportion that they have been made out of interest accruing from Federal securities, they are not subject to taxation by the State of Wisconsin under the Income Tax Laws of said state by reason of Article I, section 8, subsection 2, of the Constitution of the United States.

3. That the Court erred in failing to hold that, so far as the stock dividends here involved concerned, that is to the extent and proportion that they have been declared out of interest accruing from Federal securities, such dividends are not subject to taxation by the state of Wisconsin under the Income Tax Laws of said state

[fol. 26-30] by reason of Article I, section 8, subsection 2, and Article XIV of the Amendments to the Constitution of the United States.

4. The Court erred in failing to hold that a tax imposed under and by virtue of the Income Tax Law of the State of Wisconsin, when challenged as an impairment of a power of the Federal Government, is to be tested by its necessary operation and effect as applied and enforced without regard to the state form of the taxing scheme, or any characterization of it by the Courts of the state.

5. The Court erred in failing to hold that the tax in controversy was governed by the interpretation of the Federal Courts as to the intrinsic nature, operation and effect of a net income tax law.

6. That the Court erred in failing to hold that the tax in controversy, so far as it affects stock dividends it be construed in relation to the interpretation of the Federal Courts as to the intrinsic nature and practical effect of a stock dividend.

7. That the Court erred in holding that the case at bar was governed by the ruling in Des Moines National Bank against Fairweather, 263 U. S. 103, 44 Supreme Court Reporter, 23, and State ex rel. Dulaney vs. Nygaard, 174 Wis. 579, 183 N. W. 884.

8. That the Court erred in denying judgment in favor of the plaintiff and against the defendant for the recovery prayed for in the complaint.

Wherefore, plaintiff prays that the judgment of the said District Court be reversed.

A. W. Schutz, Attorney for Plaintiff.

[File endorsement omitted.]

[fol. 31] IN UNITED STATES DISTRICT COURT

WRIT OF ERROR—Filed Mar. 27, 1925

UNITED STATES OF AMERICA, ss:

The President of the United States to the Honorable Ferdinand A. Geiger, Judge of the District Court of the United States for the Eastern District of Wisconsin, Greeting:

Because in the record and proceedings, as also in the rendition of the judgment of appeal which is in the said District Court before you between Ernest G. Miller, plaintiff in error, and the City of Milwaukee, a Municipal Corporation, defendant in error a manifest error has happened to the damage of Ernest G. Miller, plaintiff in error as by said complaint appears. We, being willing that error, if

any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that under your seal you send the record and proceedings aforesaid, with all things concerning the same, to the Supreme Court of the United States, together with this writ, so that you have the same in the said Supreme Court at Washington within thirty days from the date hereof, that the record and proceedings aforesaid being inspected, the said Supreme Court may cause further to be done therein to correct the error, what of right, and according to the laws and customs of the United States should be done.

Witness the Honorable William Howard Taft, Chief Justice of the United States, this 27th day of March, A. D. 1925.

F. C. Westfahl, Jr., Clerk of the United States District Court for the Eastern District of Wisconsin. (Seal of the U. S. District Court, Eastern District, Wisconsin.)

[fol. 31½] [File endorsement omitted.]

[fols. 32 & 33] In United States District Court

Clerk's Certificate

United States of America,
Eastern District of Wisconsin, ss:

I, F. C. Westfahl, Jr., Clerk of the District Court of the United States of America, for the Eastern District of Wisconsin, do hereby certify that I have compared the writings annexed to this certificate with their originals now on file and remaining of record in my office, and that they are true copies of such originals, and correct transcripts therefrom, and that the same is a true copy of the record, assignment of errors and all proceedings in the case of Ernest G. Miller vs. City of Milwaukee, made pursuant to stipulation.

In testimony whereof, I have hereunto set my hand, and duly affixed the seal of said Court, at the City of Milwaukee, in said District, this 10th day of April, in the year of our Lord, one thousand nine hundred twenty-five, and of the Independence of the United States, the 149th.

F. C. Westfahl, Jr., Clerk. (Seal of the U. S. District Court, Eastern District, Wisconsin.)

[fol. 34] In Supreme Court of the United States

Stipulation as to Parts of Record to be Printed—Filed Apr. 20, 1925

It is herein and hereby stipulated by and between counsel for the respective parties to the above entitled action, that all the re-

quirements of law relating to the commencement of the above entitled action, as well as the proceedings in error subsequent to the entry of the judgment therein have been duly and properly complied with herein and that of the record and proceedings in error to this Court the following portions only shall be printed:

1. The Complaint and Exhibits.

2. Stipulation of Facts.

3. Judgment.

4. Opinion of the Court.

5. Assignment of errors and this stipulation; that no endorsement of or on any paper shall be printed.

6. Writ of Error and Clerk's Certificate.

Dated this 20th day of April, 1925.

A. W. Schutz, Attorney for Plaintiff in Error. John M. Niven, City Atty.; Walter J. Mattison, Asst. City Atty., Attorneys for Defendant in Error.

[fols. 34a & 34½] [File endorsement omitted.]

[fol. 35] In Supreme Court of the United States

Ernest G. Miller, Plaintiff,

vs.

City of Milwaukee, a Municipal Corporation, Defendant

Emil P. Miller, Plaintiff,

vs.

City of Milwaukee, a Municipal Corporation, Defendant

Harry G. John and Elise K. John, His Wife, Plaintiffs,

vs.

City of Milwaukee, a Municipal Corporation, Defendant

Charles A. Miller and Clara A. Miller, His Wife, Plaintiffs,

vs.

City of Milwaukee, a Municipal Corporation, Defendant

Stipulation to Consolidate, and That Only the Record in Case No. 370 Need be Printed—Filed April 20, 1925.

Whereas the above entitled actions involve the same question of [fols. 36 & 37] law,

Now, therefore, it is hereby stipulated and agreed by and between counsel for the respective parties by and with the leave of the Court that said cases be heard together.

It is further stipulated and agreed that the record in the first named cases, to-wit; that of Ernest G. Miller against the City of Milwaukee be alone printed and that the disposition and determination of said case shall govern the remaining cases.

Dated this 20th day of April, A. D. 1925.

A. W. Schutz, Attorney for all of the Above-named Plaintiffs in Error. John M. Niven, City Attorney; Walter J. Mattison, Asst. City Attorney, Attorneys for the Above-named Defendant in Error.

Order accordingly. Date April —, 1925. —— ——, Supreme Court Justice.

[File endorsement omitted.]

Endorsed on cover: File No. 31,055. E. Wisconsin D. C. U. S. Term No. 370. Ernest G. Miller, plaintiff in error, vs. The City of Milwaukee. Filed April 20th, 1925. File No. 31,055.

Supreme Court of the United States

OCTOBER TERM, 1925.

No. 370

FRED A. MILLER and ELISE K. JOHN, Executors of the Estate of Ernest G. Miller, Deceased,
Plaintiffs in Error,

vs.

THE CITY OF MILWAUKEE, a Municipal Corporation,
Defendant in Error.

In Error to the District Court of the United States for the Eastern District of Wisconsin.

REPLY BRIEF OF PLAINTIFFS IN ERROR

The plaintiffs in error, believing that the principal issue presented by this appeal may have been obscured by the collateral arguments advanced on both sides, respectfully begs leave of this Court to file this very brief mem-

orandum reply to the argument of the defendant in error by way of a re-statement of such issue as it appears to the plaintiffs in error.

The principal burden of the brief for the defendant in error appears to be directed in support of the proposition that a tax levied upon a stockholder in respect of his share of corporate stock is not a tax upon the corporate property. *Des Moines National Bank v. Fairweather, 263 U. S.* 103. That this proposition standing by itself admits of no refutation is conceded.

At the risk of needless repetition, therefore, plaintiffs in error desire to make the point that this proposition does not reach the issue presented by this appeal for the reason that the State of Wisconsin does not pretend to tax the share of stock or the income derived therefrom wholly and solely as such and without reference to the surplus of the corporate treasury from whom the dividend has been made.

Had the state assessed the whole income derived from the share without reference to the character of the corporate surplus, no discrimination against Federal Securities could, in the nature of things, have resulted, for the reason that the portion of the surplus made from the non-Federal surplus of the corporation would again be taxed to the shareholders, and the Federal securities would thus retain the ratio of their advantage as against the non-federal portion of the surplus. In other words, the Brief of defendant in error, it would thus appear, wholly evades the issue of discrimination, which is the gist of the grievance of the plaintiffs in error.

This brings the issue within the principles cited in the direct briefs of the plaintiffs in error.

> "Neither will the constitutionality of the statute if that be conceded avail to oust the Federal court of jurisdiction. A valid law may be wrong-

fully administered by officers of the State, and so as to make such administration an illegal burden and exaction upon the individual.

Reagan vs. Farmers Loan & Trust Co.,
154 U. S. 362, at p. 390.

"Nor can this inhibition upon the states be evaded by any change in the mode or form of the taxation provided the same result is affected, that is, an impediment is thereby imposed to the exercise of a power of the United States. That which cannot be accomplished directly cannot be accomplished indirectly. Through all such attempts the Court will look to the end sought to be reached and if that would trench upon a power of the government, the law creating it will be set aside or its enforcement restrained."

Home Insurance Company of New York,
vs. New York, 134 U. S. 594, at p. 598.

Respectfully submitted,

Counsel for Plaintiff in Error.

FILED
MAR 25 1926
WM. R. STANSBU
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BRIEF FOR PLAINTIFFS IN ERROR.

Supreme Court of the United States

OCTOBER TERM, 1925.

No. [redacted] 73

FRED A. MILLER and ELISE K. JOHN, Executors of the Estate of Ernest G. Miller, Deceased,
Plaintiffs in Error,

vs.

THE CITY OF MILWAUKEE, a Municipal Corporation,
Defendant in Error.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF WISCONSIN.

A. W. SCHUTZ,
Counsel for Plaintiffs in Error.

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Supreme Court of the United States

OCTOBER TERM, 1925.

No. 370

FRED A. MILLER and ELISE K. JOHN, Executors of the Estate of Ernest G. Miller, Deceased,
Plaintiffs in Error.

vs.

THE CITY OF MILWAUKEE, a Municipal Corporation,
Defendant in Error.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF WISCONSIN.

BRIEF FOR PLAINTIFFS IN ERROR.

The judgment sought to be reviewed was entered in the District Court for the Eastern District of Wisconsin, January 9, 1925. (R. 10) The writ of error was filed March 27, 1925. (R. 11) The case was docketed and the record filed in the Supreme Court April 20, 1925. (R. 14)

The action was commenced by the decedent for the recovery of a state income tax assessed and levied against him upon that portion of the dividends, principally stock, declared by certain corporations out of earnings derived from Federal securities in such a manner as to work an alleged discrimination thereof. (R. 1, 2, 3) The decedent claimed that said tax was assessed in contravention of the Acts of Congress passed April 24, 1917, and September 24, 1917, as amended, being

the several Liberty Bond Acts and Article XIV of the Amendments to the Constitution of the United States. (R. 3) The amount involved is in the sum of $9,368.67. (R. 3) The lower court ruled that it was bound by the Wisconsin State Supreme Court interpretation as to the inherent nature of a stock dividend and that the income from Federal securities was not in legal effect taxed by the State of Wisconsin. (R. 7, 8, 9) The jurisdiction of the Federal Court was invoked under the First Clause subdivision (a) and the Fourteenth Clause of Section 24 of The Judicial Code.

Metcalf vs. Mitchell, U. S. Decided January 11, 1926, 46 Supreme Court Reporter Advance Sheets 172;

Gillespie vs. Oklahoma, 257 U. S. 501;

Home Insurance Company of New York vs. New York, 134 U. S. 594;

McCulloch vs. Maryland, 4 Wheat. 316;

Greene vs. Louisville & Interurban R. Co., 244 U. S. 499.

The City of Milwaukee was named defendant for the reason that the tax was paid under protest to it and the statute of Wisconsin provides that suit for its recovery shall be commenced against it. Sec. 74.73, Wis. Stat. 1921, Appendix pp. 27, 28. This action does not offend against Article XI of the Constitution of the United States.

John H. Reagan, et al, as Railroad Commission of Texas vs. Farmers Loan & Trust Company, et al, 154 U. S. 362, at pp. 391, 392;

Chicago, B. & O. R. Co. vs. Osborne, 265 U. S. 14;

Ex parte Young, 209 U. S. 123, at p. 153;

County of Lincoln vs. Luning, 133 U. S. 529, at p. 530;

Poindexter vs. Greenhow, Treasurer of the City of Richmond, 114 U. S. 270, at p. 285;

Hopkins vs. Clemson College, 221 U. S. 636.

This appeal was prosecuted directly to this court from the lower Federal District Court under the authority of Sec. 238 of the Judicial Code.

Greene vs. Louisville & Interurban R. Co., 244 U. S. 499;

Metcalf vs. Mitchell, U. S. Decided January 11, 1926, 46 Supreme Court Reporter Advance Sheets 172.

STATEMENT OF THE CASE

The case was submitted upon a stipulation to the effect that the facts were as recited in the complaint with the modification that the stock and cash dividends were declared from that portion of the surplus of the corporations hereinafter mentioned, consisting of earnings wholly made out of interest accruing on Federal securities. (R. 6)

The decedent was a stockholder in three Wisconsin corporations, namely, Fred Miller Brewing Company, Oriental Investment Company, and Fred Miller Heirs, Inc. (R. 1, 3) Stock dividends of the two corporations first mentioned were declared and issued to the plaintiff. (R. 3, 4))

The corporations did not pay any tax upon that portion of the surplus from which such dividends were declared to the extent and proportion that such surplus consisted of interest accruing from Federal securities. (R. 3, 4) The Assessor thereupon *assessed for taxation to the stockholder* that portion of the dividends which was made out of the interest so accruing on Federal securities, *but assessed no tax to the stockholder* upon that proportion of the dividends made out of the surplus upon which the corporations had paid the tax. (R. 3, 4) The same general procedure was pursued in the assessment of the dividends declared by the last named corporation, namely, Fred Miller Heirs, Inc., except that both cash and stock dividends were declared by it. (R. 3). The aggregate amount for which recovery was sought was $9,368.67, being made up of the several items scheduled in Exhibit A of the complaint.

SPECIFICATION OF ERRORS RELIED UPON

The plaintiffs in error rely upon the following errors:

1. That the Court erred in directing judgment for dismissal of the complaint upon the agreed statement of facts.

2. That the Court erred in failing to hold that, so far as the dividends in controversy, whether cash or stock, are concerned, to the extent and proportion that they have been made out of interest accruing from Federal securities, they are not subject to taxation by the State of Wisconsin under the Income Tax Laws of said state by reason of Article 1, section 8, subsection 2, of the Constitution of the United States.

3. That the Court erred in failing to hold that, so far as the stock dividends here involved are concerned, that is to the extent and proportion that they have been declared out of interest accruing from Federal securities, such dividends are not subject to taxation by the state of Wisconsin under the Income Tax Laws of said state by reason of Article I, section 8, subsection 2, and Article XIV of the Amendments to the Constitution of the United States.

4. That the Court erred in failing to hold that a tax imposed under and by virtue of the Income Tax Law of the State of Wisconsin, when challenged as an impairment of a power of the Federal Government, is to be tested by its necessary operation and effect as applied and enforced without regard to the state form of the taxing scheme, or any characterization of it by the Courts of the state.

5. The Court erred in failing to hold that the tax in controversy was governed by the interpretation of the Federal Courts as to the intrinsic nature, operation and effect of a net income tax law.

6. That the Court erred in failing to hold that the tax in controversy, so far as it affects stock dividends is to be con-

strued in accordance with the interpretation of the Federal Courts as to the intrinsic nature and practical effect of a stock dividend.

7. That the Court erred in holding that the case at bar was governed by the ruling in *Des Moines National Bank vs. Fairweather*, 263 U. S. 103, and *State ex rel. Dulaney vs. Nygaard*, 174 Wis. 597.

8. That the Court erred in denying judgment in favor of the plaintiff and against the defendant for the recovery prayed for in the complaint.

I.

SUMMARY OF ARGUMENT.

This court, when called upon to test a state tax upon challenge thereto as an impairment of a power of the Federal Government, construes the tax by its necessary operation and effect as applied and enforced without regard to the state form of the taxing scheme or any characterization of it by the courts of the state.

Wagner vs. Covington, 251 U. S. 95;
U. S. vs. Reynolds, 235 U. S. 133;
Corn Products Refining Co. vs. Eddy, 249 U. S. 427;
Standard Oil Company vs. Graves, 249 U. S. 389;
Gillespie vs. State of Oklahoma, 257 U. S. 501.

II.

The particular assessment in controversy, so construed, while in form payable by the stockholder, is in truth and substance directly incident upon the property, to-wit: the earnings of the corporation, not by reason of but irrespective of

ownership as between shareholder and corporation and discriminatory of Federal securities, and as such an impairment of the borrowing power of the Federal Government, particularly so far as the stock dividends are concerned.

Section 71.01, 71.02 subsection (2b), and Section 71.04 subsection (4), of the Wisconsin Statutes, 1921, Appendix pp. 26, 27.

Income Tax Cases, 148 Wis. 456, at p. 515;
State ex rel. Sallie F. Moon Co. vs. Wis. Tax Commission, 166 Wis. 287, at p. 290;
State ex rel, Dulaney vs. Nygaard, 174 Wis. 597;
Pollock vs. Farmers Loan & Trust Co., 157 U. S. 429, at pp. 580, 581, Idem 158 U. S. 601;
Metcalf vs. Mitchell, U. S. Decided January 11, 1926, 46 Supreme Court Reporter Advance Sheets 172;
Home Insurance Co. of N. Y. vs. People of N. Y., 134 U. S. 594;
Gillespie vs. Oklahoma, 257 U. S. 501;
Eisner vs. Macomber, 252 U. S. 189;
McCulloch vs. Maryland, 4 Wheat. 316;
Home Savings Bank vs. Des Moines, 205 U. S. 503.

II-a.

The Wisconsin Supreme Court has construed a net income tax law as an excise tax.

Income Tax Cases, 148 Wis. 456, at p. 515;
State ex rel. Sallie F. Moon Co. vs. Wis. Tax Commission, 166 Wis. 287, at p. 290.

Whereas, the Federal Supreme Court has construed the identical method of taxation, when applied to the income of real or personal property, as a property tax.

Pollock vs. Farmers Loan & Trust Co., 157 U. S. 429, at pp. 580, 581; 158 U. S. 601;
Gillespie vs. Oklahoma, 257 U. S. 501;
Metcalf vs. Mitchell, U. S. Decided January 11, 1926, 46 Supreme Court Reporter Advance Sheets 172, at p. 174.

II-b.

The State Supreme Court has construed a stock dividend as income within the ordinary meaning of that term, while the high Federal Court has reached an opposite conclusion.

State ex rel. Dulaney vs. Nygaard, 174 Wis. 597;
Eisner vs. Macomber, 252 U. S. 189.

III.

So far as the stock dividends are involved, to the extent that they have been declared out of interest accruing from Federal securities, and subject to Federal interpretation, the imposition of the tax in question contravenes the due process clause of the Fourteenth Amendment.

Eisner vs. Macomber, 252 U. S. 189;
U. S. vs. B. & O. RR. Co., 84 U. S. 17 Wall. 322;
Union Refrigerator Transit Co. vs. Ky., 199 U. S. 194;
Delaware Lackawanna & W. Ry. Co. vs. Pa., 198 U. S. 341;
Louisville & J. Ferry Co. vs. Ky., 188 U. S. 385;
Frick vs. Pennsylvania, 268 U. S. 473.

ARGUMENT.

I.

This court, when called upon to test a state tax upon challenge thereto as an impairment of a power of the Federal Government, construes the tax by its necessary operation and effect as applied and enforced without regard to the state form of the taxing scheme or any characterization of it by the courts of the state.

Inasmuch as the interpretation as to the inherent nature of a general net income tax upon the part of the Federal Courts (*Pollock vs. Farmers Loan & Trust Co., supra*), and the courts of the State of Wisconsin (*State ex rel. Sallie F. Moon Co. vs. Wis. Tax Commission, supra*), are diametrically opposite one to the other, the United States tribunals holding it a tax upon the property from which the income is derived, that is, a property tax, and the state tribunals on the other hand a tax upon the right "*to produce, create, receive and enjoy*"; that is, an excise tax: as well as the mutually adverse conclusions reached by the same tribunals as to the inherent nature of a stock dividend in its relation to income in the ordinary acceptation of the term, the importance of the question of whether state or federal construction shall prevail in the case at bar becomes vital and preliminary to the construction of the major Federal questions raised by the plaintiffs in error.

The *Covington case, supra*, involved the construction of a peddler's license fee when tested by the commerce clause of the United States Constitution. Held that although courts of Kentucky may have theretofore adjudicated that sales made to a retail merchant for resale did not constitute peddling within the meaning of the statutes of that state and that so construed an ordinance of the City of Covington imposing a tax on wholesale dealers in soft drinks might have been objectionable, yet, as construed by the Supreme Court of the United States was constitutional. The following rule of construction is there announced, (p. 102):

"These decisions, however, deal merely with a question of statutory definition; and it hardly is necessary to repeat that when this court is called upon to test a state tax by the provisions of the Constitution of the United States, our decision must depend not upon the form of the taxing scheme or any characterization of it adopted by the courts of the state, but rather upon the practical operation and effect of the tax as applied and enforced. The state court could not render valid by misdescribing it, a tax law which in substance and effect was repugnant to the Federal constitution; neither can it render unconstitutional a tax that, in its actual effect, violates no constitutional provision, by inaccurately defining it."

In the *Eddy* case, *supra*, the Court said, (p. 432):

"In cases of this kind we are not concerned with the characterization or construction of the state law by the state court, nor even with the question whether it has in terms been construed, but solely with the effect and operation of the law as put in force by the state."

In the *Graves* case, *supra*, the state held an oil inspection fee an excise tax, and therefore, not a property tax upon property protected by the commerce clause, but this Court held, (p 394):

"* * * the name given to the statute is not conclusive. It must be judged by its necessary effect and if that is to violate the Constitution of the United States, the law must be declared void."

In the *Reynolds* case, *supra*, the Court held, (pp. 148, 149):

"In such cases this court must determine for itself whether a given enactment violates the Constitution of the United States or the statutes passed in pursuance thereof. If such Statutes, upon their face or in the man-

ner of their administration, have the effect to deny rights secured by the Federal Constitution, or to nullify statutes passed in pursuance thereto, they must fail."

In the *Gillespie* case, *supra*, involving the validity of state tax on income, the Court held, (p. 505):

> "The criterion of interference by the states with interstate commerce is one of degree * * *. The rule as to instrumentalities of the United States on the other hand is absolute in form and at least stricter in substance."

II.

The assessment in controversy construed in conformity with the foregoing principles, while in form payable by the stockholder, is in truth and substance directly incident upon the property of the corporation, to-wit: its earnings *not by reason of but irrespective of ownership* as between the shareholder and the corporation, and discriminatory of Federal securities, and as such an impairment of the borrowing power of the Federal Government, particularly so far as the stock dividends are concerned.

The material portions of the state statutes under which the assessment complained of was made are here quoted for the convenience of the Court:

> 71.01 "Persons and subjects taxable. There shall be assessed, levied, collected and paid a tax on all income received in each calendar year beginning with the year 1920, by every person residing within the state and by every non-resident of the state upon such income as is derived from property located or business transacted within the state, except as hereinafter exempted; provided, that all persons whose fiscal year ends on some other date than December 31, may be assessed on the income of such fiscal year in lieu of the income of the

calendar year, at the discretion of the tax commission. * * *"

71.02 "The term 'income' as used in this act, shall include:

(b) All dividends derived from stocks and all interest derived from money loaned or invested in notes, mortgages, bonds or other evidence of debt of any kind whatsoever; *provided, that the term 'dividends' as used in this section shall be held to mean any distribution made by a corporation, joint stock company or association, out of its earnings or profits accrued since January 1, 1911, and paid to its shareholders whether in cash or in stock or property of the corporation, joint stock company or association,* * * *"

71.04 "Persons other than corporations, joint stock companies or associations, in reporting incomes for purposes of taxation shall be allowed the following deductions:

"(4) Dividends or incomes received by any person from stocks or interest in any corporation, joint stock company or association, the income of which shall have been assessed under the provisions of this act; *provided that when only part of the income of any corporation, joint stock company or association shall have been assessed under this act only a corresponding part of the dividends or income received therefrom shall be deducted,* and provided further, that said corporation, joint stock company or association report the name and address of each person owning stock or having such interest and the amount of dividends or income paid such person during the assessment year."

The last proviso in italics was added to the original act and subsequently thereto by Chapter 720 of the Laws of 1913.

Under this head of the argument it will be observed that it is not the proviso *supra* which is assailed as obnoxious to

the paramount federal law, but its application to a corporate surplus in whole or in part non-taxible because of its federal character and the consequent discriminatory effect when so applied.

> "Neither will the constitutionality of the statute if that be conceded avail to oust the Federal court of jurisdiction. A valid law may be wrongfully administered by officers of the State, and so as to make such administration an illegal burden and exaction upon the individual."
>
> *Reagan vs. Farmers Loan & Trust Co.*, 154 U. S. 362, at p. 390.

The question under this head of the argument hinges in part upon a correct conclusion as to the nature of a net income tax. The state court has declared in the *Income Tax Cases*, 148 Wis. 456, at p. 515—

> "Were the income tax a tax upon property, there could be no difference in rate, for taxation of property must still be on a uniform rule, but, as has been heretofore noted, it is not a tax upon property within the meaning of our constitution."

And again in

> *State ex rel. Sallie F. Moon Co., vs. Wis. Tax Commission*, 166 Wis. 287, at p. 290,

against the dissent of three of the justices relating to inquiry into the source of dividends there involved:

> "But the tax is upon the right or ability to produce, create, receive, and enjoy, and not upon specific property."

But this Court has taken a diametrically opposite view as is evidenced by the conclusions reached in

> *Pollock vs. Farmers' Loan & Trust Co.*, 157 U. S. 429, at pp. 580, 581; 158 U. S. 601,

a decision so broad in its scope that it necessitated the adoption of the Sixteenth Amendment to the Federal Constitution, in order to permit of income taxation without apportionment. That decision voiding as it did the Federal income tax law of 1894, was bottomed upon the principle that an income tax in its very nature was a property tax, for the declared reason that a tax on income was a tax on the property from which it was made, and therefore, a direct tax, since property taxes are universally conceded to be direct taxes. This distinction was further emphasized in the equally important case of

Knowlton vs. Moore, 178 U. S. 41, at p. 81,

wherein it was held that an inheritance tax was decisively opposed in principle to the income tax in that it was an excise tax, rather than a property tax, and therefore, an indirect tax.

The principle in the *Pollock* case was recently re-affirmed in

Gillespie vs. State of Oklahoma, 257 U. S. 501; and
Metcalf vs. Mitchell, U. S. Decided January 11, 1926, 46 Supreme Court Reporter Advance Sheets 172.

In the *Gillespie* case the facts were as follows:

Chapter 164 of the laws of Oklahoma of 1915, made every person of the state liable to a tax upon his entire net income arising from all sources, except such as was exempt from taxation by some law of the United States or of the State. Under that statute Oklahoma sought in the proceeding in question to hold the defendant liable for taxes for a series of years upon the entire income derived by him as lessee of restricted Indian lands. The auditor of the state accepted the returns of the defendant as true, but held that he was liable to taxes on that portion of the income derived by him from sales of his

share of oil and gas received under his lease. The high Federal tribunal in reversing the action of the state taxing authorities as to this portion of the income held:

> "In cases where the principal is absolutely immune from interference, an inquiry is allowed into the sources from which net income is derived, and if a part of it comes from such a source, the tax is pro tanto void." (p. 505)

Citing the *Pollock* case, *supra*, the court further held, as quoted under the first division of the argument:

> "The criterion of interference by the states with interstate commerce is one of degree.***The rule as to instrumentalities of the United States on the other hand is absolute in form and at least stricter in substance." (p. 505)

The *Metcalf* case, *supra*, involved the question whether the net income of consulting engineers derived from services as such engineers under contracts with states or municipalities, or sewage districts created by state statute were exempt from the Federal income tax. While this Court denied recovery for the tax on income paid under protest, it nevertheless, recognized the principle of both the *Pollock* and *Gillespie* cases, as appears in the following language from the opinion of Mr. Justice Stone:

> "And when the instrumentality is of that character (that is intimately connected with the necessary functions of government) the immunity extends not only to the instrumentality itself but to income derived from it. (*Pollock vs. Farmers' Loan & Trust Co., Gillespie vs. Oklahoma, supra*)."

That the State of Wisconsin is taxing the surplus from which the dividends in question were made is made evident from the necessary implications resulting from the wording of the statutes under which the tax in controversy has been levied, particularly 71.04, (4), *supra*.

It would thus appear that the unit upon which the tax is imposed is the surplus out of which the dividends have been made, and that the state visits the tax primarily upon this fund for it is patent from the provisions of the statutes that if the corporation has paid the tax upon the same, the stockholder need not, and vice versa, that if the corporation has not paid the tax thereon, the stockholder is required so to do. In other words, the tax is laid upon the surplus in effect irrespective of ownership as between the shareholder and the corporation.

That the surplus is the incidence of the tax is more apparent in the case of a stock dividend under the Federal construction as to its inherent nature and effect. In *Eisner vs. Macomber*, 252 U. S. 189, at p. 202, in the opinion by Justice Pitney, we find the following language:

> "A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interests of the shareholder. Its property is not diminished, and their interests are not increased. * * * The proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest; the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of the new ones. *Gibbons vs. Mahon*, 136 U. S. 549. In short, the corporation is no poorer and the stockholder is no richer than they were before. *Logan County vs. United States*, 169 U. S. 255. If the plaintiff gained any small advantage by the change, it certainly was not an advantage of $417,450.00, the sum upon which he was taxed. * * * What has happened is that the plaintiffs' old certificates have been split up in effect and have diminished in value to the extent of the value of the new."

This tax, therefore, in contemplation of this view as to the inherent nature of a stock dividend would seem to fall upon the surplus out of which the stock dividends were declared and therefore, on the earnings from the Federal securities, of which that surplus consists.

Even the state Supreme Court does not appear to consider the certificates of stock as the source from which the income is derived, or consistently the tax thereon as an excise and preclude all inquiry into the surplus, but rather itself considers the surplus as the incidence of the tax. This is made evident by the following pertinent extract from the opinion of Justice Eschweiler, in the case of

State ex rel. Moon vs. Nygaard, 170 Wis. 415, p. 418, Decided January 13, 1920.

> "We construe the legislative definition now applicable to the term 'dividend' as it stands in the amended *Sec. 1087m-2* (renumbered 71.02 (2b.) supra) as intended to now permit the opening of the door of inquiry as to the source from which came the money paid by a corporation to its stockholders, although designated by it as dividends, the door which was in effect declared in the prior cases completely closed. The result now is that a stockholder in any corporation to whom, as stockholder, there has been paid a sum of money under the designation of dividends has the right to show that such payment or dividend was made out of capital or surplus and therefore not taxable instead of out of earnings or profits accrued since January 1, 1911, which would be taxable. That the fund in question passes through the treasury of the Sallie F. Moon Company after leaving that of the Northwestern Lumber Company, and before reaching the hands of the relators, does not change the nature of the transaction. At no time on its passage from the first company to the relators does it meet the present definition of the dividend which is to be considered as part of the taxable income of an individual."

The decision in this case was based upon the amendment of the income tax law effected by *Chapter 247 of the Laws of 1917*, which amendment reads as follows:

> "Provided that the term 'dividends' as used in this

section shall be held to mean any distribution made by a corporation, joint stock company or association, out of its earnings or profits accrued since January 1, 1911, and paid to its shareholders whether in cash or in stock of the corporation, joint company or association."

Again, it here appears that the statute visits the tax upon the surplus, irrespective of its ownership as between shareholder and corporation, for unless the capital of the corporate entity is regarded as the capital of the shareholder, there would be no reason in the law for permitting the shareholder to show that his income was paid out of the capital of the corporation. In any other relationship than that of corporation and shareholder under the state act, it is no objection or impediment to the imposition of an income tax that A's income is made out of B's capital.

It is as if the state when subjecting master and servant to taxation provided that the earnings of the servant were to be taxed only upon that portion of the master's earnings out of which the servant's had been derived and upon which the master had not paid the tax; but, that in the event that the master had paid the tax or the extent to which he had paid it the servant would pay none. Clearly, such a tax is not imposed by reason of ownership but irrespective of the ownership as between the two and is a tax on the specific res.

In view, therefore, of the intrinsic nature of an income tax as construed by the Federal Courts as a tax upon the property from which it is derived, and clearly implied purpose of the state to subject the surplus in question to taxation, the plaintiffs in error challenge as inapplicable the Federal authorities holding that a share of stock considered as an incident of the corporal franchise and taxed to the shareholder by reason of ownership, may be made the subject of the state tax, even though the assets of the corporation issuing the same may consist in whole or in part of Federal tax exempt securities.

The tax in the case at bar is not imposed by reason of ownership in the shareholder or the corporation exclusive of the

other, but on the contrary irrespective of ownership as between the two. In other words, if one does not pay the tax on the surplus, the other must, and vice versa. Whereas, a tax on a share of stock does not purport to be levied upon the corporate surplus earnings or other assets, but on the contrary is directed only at the intangible right evidenced by a stock certificate declaring the proportion in which the stockholders shall participate in the corporate earnings and the division of assets, inhering in such stockholders as entities entirely distinct from the corporation and the corporate property. Such a tax is in its essential nature an excise tax and not a property tax, although both a corporate franchise and a share of stock are personal property.

For example, an excise tax under the Federal decisions has been uniformly upheld whereby a state is permitted to tax the corporate franchise and measure the tax by its earnings, even though such earnings may consist in part of the proceeds of Federal securities, whereas the same tax imposed as a property tax or an income tax on the property giving rise to the value of the shares would be beyond the power of the state to impose. *Home Insurance Company of New York vs. People of New York*, 134 U. S. 594; in other words, to reduce the proposition to its lowest terms: in the one case, the franchise, to-wit: the corporate charter, or one of the principal and integral incidents of that franchise, to-wit: the share of stock is the subject of the tax, while in the other, the property giving value to the franchise or the certificate of stock, is the thing taxed, and the Courts are unanimous that when that property consists in part of Federal instrumentalities, the state power to tax is protanto suspended.

This question, therefore, resolves itself into a pure question of power to do one or the other thing, and not into an inquiry as to whether the state could accomplish lawfully a greater revenue yielding result so far as the money proceeds of the tax is concerned.

Home Savings Bank vs. Des Moines, 205 U. S. 503, at p. 519.

> "It is said that where a tax is levied upon a corporation, measured by the value of the shares in it, it is equivalent in its effect to a tax (clearly valid) upon the shareholders in respect of their shares, because, being paid by the bank, the burden falls eventually upon the shareholders in proportion to their holdings. It was upon this view that the lower court rested its opinion. But the two kinds of taxes are not equivalent in law, because the state has the power to levy one, and has not the power to levy the other. The question here is one of power, and not of economics. If the state has not the power to levy this tax, we will not inquire whether another tax, which it might lawfully impose, would have the same ultimate incidence."

For this reason, the source from which the stock certificates derive their value, cannot be inquired into when taxed by the state wholly as such. Here the state taxes not the certificates of stock, but the corporate earnings, to-wit: the surplus out of which they have been declared, and requires payment of the tax by either stockholder or corporation.

Manifestly the state taxation scheme operates in the situation presented by the case at bar to reach that portion of the surplus which was tax exempt by reason of the Federal prohibition, and, therefore, the following general principle announced in

> *Home Insurance Company of New York vs. New York*, 134 U. S. 594

is believed to be in point, (p. 598):

> "Nor can this inhibition upon the states be evaded by any change in the mode or form of the taxation provided the same result is effected, that is, an impediment is thereby imposed to the exercise of a power of the United States. That which cannot be accomplished directly cannot be accomplished indirectly. Through all such attempts the Court will look to the end sought to be reached and if that would trench upon a power of the

> government, the law creating it will be set aside or its enforcement restrained."

As the Wisconsin law now stands, and the particular manner in which the same has been enforced as applied to the facts in the instant case, the Federal securities are made the covert butt of the ingeniously contrived state taxation scheme, resulting in the tax complained of, for the obvious practical reason that substantially the only tax payable by stockholders on account of the corporate earnings in question, are earnings accruing from Federal securities, or to restate the proposition, conversely, the stockholders in corporations choosing to invest their capital in whole or in part in Federal instrumentalities, are singled out and penalized because of such investment. The natural tendency of such a policy is to make Federal securities with their low rate of interest less attractive than stable investments in real mortgage and other securities bearing a safe but considerably higher rate of interest, and thereby deprive the Federal securities of their availability and advantages for corporate investment as against other forms of investment. A method has been discovered whereby such government securities have in a very real sense become the object of state discrimination.

III.

So far as the stock dividends are involved, to the extent that they have been declared out of interest accruing from Federal securities, and subject to Federal interpretation, the imposition of the tax in question contravenes the due process clause of the Fourteenth Amendment.

The second branch of plaintiffs' argument, based as it is upon the proposition that a stock dividend viewed as an original proposition, and in contemplation of the Federal Courts, does not constitute income, it becomes important to analyze the basis of the holding in the *Macomber* case, *supra*.

It will be noted that the decision in that case is planted squarely and without equivocation upon the conception of a stock dividend as a mere proliferation, as one of the lower Federal Judges has put it, or cellular resubdivision of the original antecedent shares of stock, and that no gain or profit in the true sense of the word can be said to accrue to the stockholder until the sale of one or more of his shares, the surplus remaining in the corporate treasury with complete dominion there-over remaining in the corporation.

It therefore appears that the State of Wisconsin so far as the stock dividends in the instant case are involved is undertaking in contemplation of the view adopted in the *Macomber* case, *supra*, to tax the stockholder for income received not by him but by the corporation. We have a situation analogous to that passed upon by this Court in *United States vs. Baltimore & Ohio R. R. Co.*, 84 U. S. 322. In that case the Federal Government attempted to collect from the Railroad the sum of $87,000.00 being the tax upon interest accruing on certain bonds payable by the Railroad to the City of Baltimore under an Act of Congress levying a tax of five per cent upon the income derived from corporate securities, and making same payable by the corporation issuing the same, but the Court holding as it did, that this sum of money was not income as to the railroad, but was income as to the city, held it to be exempt as being a tax on an instrumentality of the state, and that collection of the sum from the railroad would have amounted to the collection of an income tax from A on B's income. The court in that connection declared (p. 326):

> "A tax is understood to be a charge, a pecuniary burden, for the support of government. Of all burdens imposed upon mankind, that of grinding taxation is the most cruel. *It is not taxation that government should take from one the profits and gains of another. That is taxation which compels one to pay for the support of the government from his own gains and of his own property.*"

In the case at bar the stockholder having received no income and the property purporting to be evidenced by the stock certificates as for the surplus remaining in the corporate treasury, the stockholder is in effect compelled to pay a tax on the gains and profits of the corporation without himself having received them.

In the case of the *Union Refrigerator Transit Company vs. Kentucky*, 199 U. S. 194, this Court held that taxation amounting to an extortion is within the due process clause of the Fourteenth Amendment of the Federal Constitution.

While this case laid down the rule that tangible personal property permanently located outside of a state, although the owner was domiciled in the taxing state, was not taxable by the state of domicile, yet the principle of confiscatory taxation as repugnant to the Federal Constitution, is laid down in the case in the following language, (pp. 202, 203):

> "In *C. B. & Q. RR. Co. vs. Chicago*, 166 U. S. 226, it was held after full consideration that the taking of private property without compensation was a denial of due process within the Fourteenth Amendment."

To the same effect are

> *Delaware Lackawanna & Western RR. Co. vs. Pennsylvania*, 198 U. S. 341;
> *Louisville & J. Ferry Co. vs. Kentucky*, 188 U. S. 385;
> *Frick vs. Pennsylvania*, 268 U. S. 473.

It is a fair query whether such taxation accords the stockholder the equal protection of the law since no other taxpayer in Wisconsin is required to pay an income tax on his capital.

It is, therefore, submitted that under the doctrine of *Eisner vs. Macomber, supra*, when the respondents in these proceedings received their several stock dividends, they received in truth and in fact, a script or piece of paper re-evidencing their proprietary interest in the corporation, and nothing more. Until such proprietary interest or any part thereof, shall

have been disposed of, no gain will actually have been realized by them.

It appears to logically follow that an income tax levied upon one person in respect of the income not received by him but by another is the taking of property without due process of law within the meaning and principle of the foregoing authorities.

In conclusion it is earnestly contended that under the principles and authorities forming the basis of plaintiffs' argument both as to the impairment of the Federal power involved, and the alleged taking of property without due process of law, plaintiffs in error believe themselves entitled to the protection and relief of this court in accordance with the prayer of the complaint, and that accordingly judgment of the lower court ought to be reversed.

Respectfully submitted,

Counsel for Plaintiffs in Error.

APPENDIX

FEDERAL STATUTES CITED.

Act of Congress, April 24, 1917, c. 4, sec. 1, 40 Stat. 35:

"First Liberty loan; amount; bonds. The Secretary of the Treasury, with the approval of the President, is hereby authorized to borrow, from time to time, on the credit of the United States for the purposes of this Act, and to meet expenditures authorized for the national security and defense and other public purposes authorized by law not exceeding in the aggregate $5,000,000,000, exclusive of the sums authorized by section four of this Act, and to issue therefor bonds of the United States.

"The bonds herein authorized shall be in such form and subject to such terms and conditions of issue, conversion, redemption, maturities, payment, and rate and time of payment of interest, not exceeding three and one-half per centum per annum, as the Secretary of the Treasury may prescribe. The principal and interest thereof shall be payable in United States gold coin of the present standard of value and shall be exempt, both as to principal and interest, from all taxation, except estate or inheritance taxes, imposed by authority of the United States, or its possessions, or by any State or local taxing authority; but such bonds shall not bear the circulation privilege."

Act of Congress, September 24, 1917, c. 56, sec. 7, 40 Stat. 291:

"* * * All such bonds and certificates shall be exempt, both as to principal and interest from all taxation now or hereafter imposed by the United States, any state or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes and excess profits and war-profits taxes now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations or corporations. * * *"

Other Liberty Bond Acts are similar so far as the points of law are here involved.

The Judicial Code, sec. 24, 1st clause, subdiv. (a) and 14th clause:

"The district courts shall have original jurisdiction as follows:

"First. Of all suits of a civil nature, at common law or in equity, brought by the United States, or by any officer thereof authorized by law to sue, or between citizens of the same State claiming lands under grants from different States; or, where the matter in controversy exceeds, exclusive of interest and costs, the sum or value of three thousand dollars, and (a) arises under the Constitution or laws of the United States, or treaties made, or which shall be made, under their authority."

"Fourteenth. Of all suits at law or in equity authorized by law to be brought by any person to redress the deprivation, under color of any law, statute, ordinance, regulation, custom, or usage, of any State, of any right, privilege or immunity, secured by the Constitution of the United States, or of any right secured by any law of the United States, providing for equal rights of citizens of the United States, or of all persons within the jurisdiction of the United States."

The Judicial Code, sec. 238:

"Appeals and writs of error may be taken from the district courts, including the United States district court for Hawaii and the United States district court for Porto Rico, direct to the Supreme Court in the following cases: In any case in which the jurisdiction of the court is in issue, in which case the question of jurisdiction alone shall be certified to the Supreme Court from the court below for decision; from the final sentences and decrees in prize causes; in any case that involves the construction or application of the Constitution of the United States; in any case in which the constitutionality of any law of the United States or the validity or construction of any treaty made under its authority is drawn

in question; and in any case in which the constitution or law of any State is claimed to be in contravention of the Constitution of the United States."

The foregoing is the reading of the section prior to its amendment by Act of Congress February 13, 1925, c. 229, sec. 1, 43 Stat. 938; c.

STATE STATUTES CITED.

"71.01. Persons and subjects taxable. There shall be assessed, levied, collected and paid a tax on all income received in each calendar year beginning with the year 1920, by every person residing within the state and by every non-resident of the state upon such income as is derived from property located or business transacted within the state, except as hereinafter exempted; provided, that all persons whose fiscal year ends on some other date than December 31, may be assessed on the income of such fiscal year in lieu of the income of the calendar year, at the discretion of the tax commission * * *"

"71.02 (2). The term 'income' as used in this act, shall include:

(b) All dividends derived from stocks and all interest derived from money loaned or invested in notes, mortgages, bonds or other evidence of debt of any kind whatsoever; provided, that the term 'dividends' as used in this section shall be held to mean any distribution made by a corporation, joint stock company or association, out of its earnings or profits accrued since January 1, 1911, and paid to its shareholders whether in cash or in stock or property of the corporation, joint stock company or association."

"71.04. Persons other than corporations, joint stock companies or associations, in reporting incomes for purposes of taxation shall be allowed the following deductions:

(4) Dividends or incomes received by any persons from stocks or interest in any corporation, joint stock company or association, the income of which shall have been assessed un-

der the provisions of this act: *provided that when only part of the income of any corporation, joint stock company or association shall have been assessed under this act only a corresponding part of the dividends or income received therefrom shall be deducted*, and provided, further, that said corporation, joint stock company or association report the name and address of each person owning stock or having such interest and the amount of dividends or income paid such person during the assessment year."

The proviso in italics was added to the original act and subsequent thereto by Chapter 720 of the Laws of 1913.

"74.73. Recovery of illegal taxes; limitation. (1) Any person aggrieved by the levy and collection of any unlawful tax assessed against him may file a claim therefor against the town, city, or village, whether incorporated under general law or special charter, which collected such tax in the manner prescribed by law for filing claims in other cases, and if it shall appear that the tax for which such claim was filed or any part thereof is unlawful and that all conditions prescribed by law for the recovery of illegal taxes have been complied with, the proper town board, village board, or common council of any city, whether incorporated under general law or special charter, may allow and the proper town, city, or village treasurer shall pay such person the amount of such claim found to be illegal and excessive. If any town, city or village shall fail or refuse to allow such claim, the claimant may have and maintain an action against the same for the recovery of all money so unlawfully levied and collected of him. Every such claim shall be filed; and every action to recover any money so paid shall be brought within one year after such payment and not thereafter.

(2) In case any such town, city, or village shall have paid such claim or any judgment recovered thereon after having paid over to the county treasurer the state and county tax levied and collected as part of such unlawful tax, such town, city, or village shall be credited by the county treasurer, on the settlement with the proper treasurer for the

taxes of the ensuing year, the whole amount of such state and county tax so paid into the county treasury with the county's and state's proportionate share of the taxable costs and expenses of suit; and the county treasurer shall also be allowed by the state treasurer the amount of state tax so illegally collected with the state's proportionate share of the taxable costs and expenses of suit and paid in his settlement with the state treasurer next after the payment of such claim or the collection of such judgment. If any part of such unlawful tax shall have been paid over to any school district before the payment of such claim or judgment, such town shall charge the same to such district with the proportionate share of the taxable costs and expenses of suit, and the town clerk shall add the same to the taxes of such school district in the next annual tax; provided, however, that no claim shall be allowed and no action shall be maintained under the provisions of this section unless it shall appear that the plaintiff has paid more than his equitable share of such taxes."

[redacted]

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IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1926

No. 73

(No. 370, Oct. Term, 1925)

FRED A. MILLER and ELSIE K. JOHN, Executors of the Estate of Ernest G. Miller, Deceased,
Plaintiffs in Error,

vs.

THE CITY OF MILWAUKEE, a Municipal Corporation,
Defendant in Error.

In error to the District Court of the United States for the Eastern District of Wisconsin.

BRIEF FOR DEFENDANT IN ERROR.

This action was commenced by the decedent of plaintiffs in error for the recovery of income taxes paid by him under protest to the City of Milwaukee, said income tax being assessed, levied and collected under and by virtue of the statutes of the State of Wisconsin relating to income taxes. Judgment was entered in the District Court for the Eastern District of Wisconsin on January 9, 1925, Hon. Evan A. Evans, judge presiding, in favor of the defendant in error, and plaintiffs in error appeal to the Supreme Court of the United States.

STATEMENT OF FACTS.

The facts in the case are not in dispute, being submitted upon stipulation. They are briefly set forth on page 3 of the brief for plaintiffs in error.

The facts show that the deceased Ernest G. Miller was a stockholder in three Wisconsin corporations, each of which owned tax-exempt federal securities. Earnings from these securities were credited by the corporations receiving them to surplus. Later, cash and stock dividends were declared by such corporations to the stockholders out of surplus. Decedent as a stockholder received his proportional share of said dividends. It is conceded that the amount which the plaintiffs in error seek to recover in this action is the tax based on that portion of the dividends received by decedent which came out of so much of the surplus as was made up out of earnings of the corporations from interest on such tax-exempt federal securities.

The said corporations did not pay an income tax in the State of Wisconsin based upon earnings from such tax-exempt securities, and plaintiffs in error seek to have this exemption extended to the stockholders of said corporations insofar as the dividends paid said stockholders by the corporations from surplus were declared out of earnings accruing from such tax-exempt securities.

It is conceded that all preliminary statutory requirements have been complied with by the plaintiffs in error and the decedent in bringing this action for recovery of the alleged illegal tax.

CONTENTION OF PLAINTIFFS IN ERROR.

Plaintiffs in error base their right to recover on two contentions:

1. That income on Federal securities is being taxed.

2. That stock dividends to the extent and proportion that they have been declared out of interest accruing from Federal securities are subject to interpretation as to the inherent nature of a stock dividend when challenged upon a Federal ground and that the imposition of the state tax in question contravenes the Fourteenth Amendment of the Federal Constitution.

CONTENTION OF DEFENDANT IN ERROR.

The position of the defendant in error is as follows:

1. That Federal securities are not being taxed by the state. This is for the reason that such securities were not owned by the plaintiffs' decedent, but by corporations of which decedent was a stockholder. The tax, therefore, was based upon the income of the decedent from ordinary dividends declared by such corporations and not upon the income of the corporations from the tax-exempt securities.

2. That the constitution of Wisconsin authorizes the imposition of a tax upon income and the statutes of Wisconsin define stock dividends to be income and taxable as such. These statutes are valid enactments under the Wisconsin constitution and are not in contravention of the Constitution of the United States.

THE ISSUES INVOLVED.

There are two broad questions involved in this case:

1. Has the State of Wisconsin the authority to declare stock dividends to be taxable income?

2. Has a taxpayer in the State of Wisconsin the right to go behind the corporate entity of a corporation to show that the dividends received by him as a stockholder originated from interest on tax-exempt Federal securities?

THE CONSTITUTIONAL PROVISION AND STATUTES INVOLVED.

The constitution of the State of Wisconsin, as amended in 1908 to authorize the imposition of taxes on incomes, reads as follows (the amendment being in italics):

> "Article VIII, Section 1.—The rule of taxation shall be uniform, and taxes shall be levied upon such property as the legislature shall prescribe. *Taxes may also be imposed on incomes, privileges and occupations, which taxes may be graduated and progressive, and reasonable exemptions may be provided.*"

The following sections of the Wisconsin income tax law are involved and will be discussed hereinafter:

> Sec. 71.01. *Persons and subjects taxable.* There shall be assessed, levied, collected and paid a tax on all income received in each calendar year beginning with the year 1920, by every person residing within the state and by every non-resident of the state upon such income as is derived from property located or business transacted within the state, except as hereinafter exempted; ***
>
> Sec. 71.02. *Definition of terms; what income taxable.*
>
> (1) ****.
>
> (2) The term 'income' as used in this act, shall include.
>
> * * * * * * *
>
> (b) All dividends received from stocks * * *, provided that the term dividends as used in this section shall be held to mean any distribution made by a corporation * * * out of its earnings or profits accrued since January 1, 1911 and paid to its shareholders whether in cash or in stock of the corporation, * * *.
>
> * * * * * * *
>
> (h) And all other gains, profits or income of any kind derived from any source whatever except such as hereinafter exempted.

ARGUMENT

I.

THE ONLY QUESTION HERE PRESENTED IS WHETHER DIVIDENDS OF CORPORATIONS, TO THE EXTENT TO WHICH THEY WERE EARNED BY SUCH CORPORATIONS OUT OF THE INCOME OF TAX EXEMPT FEDERAL SECURITIES, MAY LEGALLY BE ASSESSED TO THE STOCKHOLDERS AS INCOME UNDER THE CONSTITUTION AND LAWS OF WISCONSIN.

No contention is made in this case that the tax in question was illegally assessed, levied or collected, other than that the particular dividends involved were not "income" within the meaning of the Wisconsin constitution and income tax laws. It is not claimed that there was any irregularity in the proceedings involved in the assessment, levy or collection of the tax. Nor is it claimed that the state law does not make ample provision by way of notice, hearings or otherwise for the protection of the rights of taxpayers or that the plaintiffs in error have been deprived of their day in court; on the contrary the complaint specifically shows that the decedent of plaintiffs in error availed himself of the entire machinery of the law provided for the protection of taxpayers. It is not contended that the income in question is exempt by any express provision of the state law, nor is there any question as to the proper amount of the tax, assuming that the dividends in question are legally assessable as income under the law.

Accordingly, there is presented in this case the one broad question—Are dividends of corporations, to the extent to which they are earned by such corporations out of the income of tax-exempt securities, legally assessable to the stockholders as income under the constitution and laws of Wisconsin?

II.

THE TAX IS VALID UNDER THE CONSTITUTION AND LAWS OF WISCONSIN.

At the very outset of this brief we desire to impress upon the court that the tax complained of is valid under the laws of Wisconsin and that, unless plaintiffs in error can sustain their contention that this court will give the state constitution and income tax laws an interpretation other than that given by the supreme court of Wisconsin, their cause of action must fall.

The constitutional provision of Wisconsin relative to income taxes and the statutes passed pursuant thereto and involved herein have been previously printed in this brief and need not be again set out at length. We will, therefore, refer here only briefly to such of these as are of particular application to the question under discussion.

Prior to the adoption of the 1908 amendment, the simple rule of taxation prescribed by the constitution of Wisconsin was:

> "The rule of taxation shall be uniform, and taxes shall be levied upon such property as the legislature shall prescribe." Article VIII, Sec. 1.

Since the amendment of 1908, this section of the constitution reads as follow (the amendment being in italics):

> Art. VIII, Sec. 1. "The rule of taxation shall be uniform, and taxes shall be levied upon such property as the legislature shall prescribe. *Taxes may also be imposed on icomes, privileges and occupations, which taxes may be graduated and progressive, and reasonable exemptions may be provided.*"

The original income tax statute (chapter 658, laws of 1911) passed pursuant to the above amendment, provided that the word "income" as used in the act should include:

"All dividends or profits derived from stock or from the purchase and sale of any property or other valuables acquired within three years previous or from any business whatever." (Section 1087m-2).

The constitutionality of this statute was challenged but was sustained by the supreme court of Wisconsin.

Income Tax Cases, 148 Wis. 456.

The supreme court of Wisconsin has consistently held that the word "income" in the constitutional amendment and in the income tax statute enacted pursuant thereto was used in its common, ordinary meaning and not in its strict, technical, or true economic sense; and that it included ordinary dividends paid by going corporations, as distinguished only from dividends declared in cancellation of stock liability. This is still the law in Wisconsin.

Van Dyke vs. Milwaukee, 159 Wis. 460;

State ex rel Bundy vs. Nygaard, 163 Wis. 307;

Westby vs. Bekkedal, 172 Wis. 114;

State ex rel Dulaney vs. Nygaard, 174 Wis. 597.

See also

State ex rel Pfister vs. Widule, 166 Wis. 48, and
State ex rel Nunnemacher vs. Widule, 166 Wis. 55.

The supreme court of Wisconsin early adopted the view, and has steadfastly adhered to it, that the income tax is not a tax upon property but that it is a tax upon the recipient of the income. In an opinion by the late Chief Justice Winslow this ruling was laid down as follows:

"There can be no doubt of the proposition that income taxation of a progressive character, in addition to taxation of property, is directly authorized by the constitution of Wisconsin, as amended in 1908. Words could hardly be plainer to express that idea than the

words used. From them it clearly appears that taxation of property and taxation of incomes are recognized as two separate and distinct things in the state constitution; both may be levied, and lawfully levied, because the constitution says so. However philosophical the argument may be that taxation of rents received from property is in effect taxation of the property itself, the people of Wisconsin have said that 'property' means one thing, and 'income' means another; in other words, that income taxation is not property taxation, as the words are used in the constitution of Wisconsin."

Income Tax Cases, 148 Wis. 456, 507.

This ruling was adhered to in a later case. The court in an opinion by present Chief Justice Vinje uses the following language:

"Much confusion of thought arises from regarding the income tax as a tax that is levied upon or attaches to property as such, irrespective of the person sought to be taxed. It is the recipient of the income that is taxed—not his property,—and the vital question in each case is, Has the person sought to be taxed received an income during the tax year? If so, such income, unless specifically exempted, is subject to a tax though the property out of which it is paid may have been exempt from an income tax in the hands of the payor. It is the relation that exists between the person sought to be taxed and specific property claimed as income to him that determines whether there shall be a tax. If the person sought to be taxed is the recipient during the tax year of such specific property as income in its ordinary significance, then the person is taxed. But the tax is upon the right or ability to produce, create, receive, and enjoy and not upon specific property. Hence, the amount of the tax is measured by the amount of the income irrespective of the amount of specific property or ability necessary to produce or create it. In the ordinary acceptation of the term this may be said to be a tax upon income as the statute denominates it. But the tax does not seek to reach

property or an interest in property as such. It is a burden laid upon the recipient of an income. State ex rel Manitowoc G. Co. vs. Wis. Tax Com. 161 Wis. 111, 152 N. W. 848; State ex rel Bundy vs. Nygaard, 163 Wis. 307, 158 N. W. 87."

State ex rel Sallie F. Moon Co. vs. Wis. Tax Comm., 166 Wis. 287, 290.

See also

Paine vs. City of Oshkosh (Wis.), 208 N. W. 790.

By chapter 247, laws of 1917, the law was amended so as to expressly declare dividends, whether in stock or in cash, to be income. By this amendment section 1087m-2(b), which is now section 71.02(2)(b), was made to read (the amendment being in italics):

"2. The term 'income,' as used in this act, shall include: . . .

"(b) All dividends derived from stocks and all interest derived from money loaned or invested in notes, mortgages, bonds or other evidence of debt of any kind whatsoever, *provided, that the term 'dividends' as used in this section shall be held to mean any distribution made by a corporation, joint stock company or association, out of its earnings or profits accrued since January 1, 1911, and paid to its shareholders whether in cash or in stock of the corporation, joint company or association.*"

By this amendment the laws of Wisconsin in clear and unmistakable terms declared stock dividends to be income and taxable as such.

The law as so amended was attacked upon the ground that stock dividends could not legally be assessed as income. The supreme court of Wisconsin upheld the validity of the law. In an able opinion by Justice Burr W. Jones,

the court adhered to its previous decisions (above referred to) wherein the term "income" as used in the constitutional provision was held to be given a broad and liberal, rather than a technical and restricted, meaning.

State ex rel Dulaney vs. Nygaard, 174 Wis. 597.

The opinion in this case points out that the supreme court of Wisconsin was not bound to construe its said constitutional provision in the light of other constitutional provisions standing in the way of extending its construction or preventing its being given the commonly accepted meaning of the term "income", as was the Supreme Court of the United States in construing the Federal constitutional provision involved in *Eisner vs. MaComber,* 252 U. S. 189. The court found that on the contrary the state court was under no such restriction; that the constitution of Wisconsin subjects "incomes" to taxation, without limitation or restriction. The court therefore adopted the rule prevailing in Massachusetts and New York, gave the word "income" as used in the state constitution its commonly accepted meaning, and held the statute to be valid.

In connection with this decision it may be well to point out that in giving this construction to the word "income" the state court was not making any revolutionary interpretation nor was the legislature in adopting the phraseology so construed enunciating any new or startling doctrine. As shown in the opinion the term "income" had a settled and well-determined meaning in Wisconsin prior to the enactment of the statute in question as between life tenant and remainder-man, and the court found that this term had not acquired any different meaning prior to the adoption of the constitutional amendment in question. A similar interpretation had been given to identical constitutional provisions by the courts of Massachusetts and New York.

In this connection it should also be noted that in the case of *Eisner vs. MaComber*, 252 U. S. 189, four justices dissented in the belief that the word "income" as used in the Federal Constitution should be construed to include stock dividends. The majority opinion took the view that the court was limited in its construction by other restrictive constitutional provisions, so that it is not clear that even the majority of the court would not have agreed with the supreme court of Wisconsin had identical constitutional provisions been under consideration. This distinction between constitutional provisions is pointed out by Justice Pitney in the following language, referring to the case of *Tax Commissioner vs. Putnam*, 227 Mass. 522:

> "The Massachusetts court was not under any obligation, like the one which binds us, of applying a constitutional amendment in the light of other constitutional provisions that stand in the way of extending it by construction."

He further says:

> "The 16th Amendment must be construed in connection with the taxing clauses of the original Constitution and the effect attributed to them before the Amendment was adopted. In Pollock vs. Farmers Loan & Trust Company, 158 U. S. 601, * * * it was held that taxes upon rents and profits of real estate and upon returns from investments of personal property were in effect direct taxes upon the property from which such income arose, imposed by reason of ownership; and that Congress could not impose such taxes without apportioning them among the states according to population. * * * Afterwards, and evidently in recognition of the limitation upon the taxing power of Congress thus determined, the 16th Amendment was adopted, in words lucidly expressing the object to be accomplished: 'The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several

states, and without regard to any census or enumeration.' As repeatedly held, this did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the states of taxes laid on income."

Eisner vs. MaComber, 252 U. S. 189.

In this decision the Wisconsin supreme court followed the rule in two other states, Massachusetts and New York.

Tax Commissioner vs. Putnam, 227 Mass. 522;
People vs. Glynn, 198 N. Y. 605.

It is therefore submitted that the highest court of last resort in the State of Wisconsin has not only declared the statute under consideration to be valid and constitutional but that this decision is supported by reputable authorities in other states and is not at variance with the ruling of the Supreme Court of the United States.

Before passing on to the next point in our argument, we wish to discuss briefly the case of *State ex rel Moon vs. Nygaard*, 170 Wis. 415, which is referred to in the brief of plaintiffs in error on page 16 as being somewhat in conflict with previous decisions of the state supreme court. In order to clearly understand the scope of this decision it is necessary to have in mind the previous income tax statute and the decisions of the state court construing the same.

Prior to chapter 247 of the laws of 1917, which amended the statute so as to define dividends, the statute defined income to include "all dividends received from stocks and all interest derived from money loaned or invested in notes, mortgages, bonds or other evidence of debt of any kind whatsoever."

Section 1087m-2 2(b), Stat. of 1915.

In construing this statute the supreme court of Wisconsin held that ordinary dividends paid by a going corporation, as distinguished only from dividends in cancellation of stock liability, would be conclusively presumed to be from earnings or profits for purposes of income taxation.

Van Dyke vs. Milwaukee, 159 Wis. 460;
State ex rel Pfister vs. Widule, 166 Wis. 48;
State ex rel Nunnemacher vs. Widule, 166 Wis. 55.

It will be apparent that the statute in its then form worked a hardship in certain instances. Cases might arise and doubtless did arise where dividends declared to stockholders were actually not out of profits or earnings but out of capital. In the ramifications of corporate management it would be surprising if situations of this kind did not occasionally arise.

It was in order to remedy this situation that the 1917 amendment was passed. This amendment (chapter 247) added to the statute just above quoted a definition of the term "dividends" so that the statute was made to read as follows (the amendment being in italics):

> "(2) (b) All dividends derived from stocks and all interest derived from money loaned or invested in notes, mortgages, bonds or other evidence of debt of any kind whatsoever, *provided, that the term 'dividends' as used in this section shall be held to mean any distribution made by a corporation, joint stock company or association, out of its earnings or profits accrued since January 1, 1911, and paid to its shareholders whether in cash or in stock of the corporation, joint company or association.*"
>
> *Subsec. 2 (b) of section 1087m-2 of the 1915 statutes,* (now 71.02(2)(b).

It is manifest that the purpose of the amendment was to enable the stockholder to show that as a matter of fact a dividend received by him was paid by the corporation out of capital and not out of earnings or profit. In other words, the stockholder was no longer bound by the conclusive presumption that all dividends received by him were out of earnings or profit. This and no more was decided by the court in *State ex rel Moon vs. Nygaard,* 170 Wis. 415, as

appears conclusively from the language of the court. In fact, no other issue was before the court for determination. While the opinion of the court states that by the amendment the door of inquiry was open as to the source from which came the money paid by a corporation to its stockholders, although designated as dividends, it is clear that such inquiry was limited to the question of whether the money came from capital or from earnings or profits. This is made clear by the following language of the opinion:

> "The result now is that a stockholder in any corporation to whom, as stockholder, there has been paid a sum of money under the designation of dividends has the right to show that such payment or dividend was made out of capital or surplus and therefore not taxable instead of out of earnings or profits accrued since January 1, 1911, which would be taxable. That the fund in question passes through the treasury of the Sallie F. Moon Company after leaving that of the Northwestern Lumber Company, and before reaching the hands of the relators, does not change the nature of the transaction. At no time on its passage from the first company to the relators does it meet the present definition of the dividend which is to be considered as part of the taxable income of an individual."

That this case is limited in its application as above stated and works no other change in existing law of this state is indicated by the decision of the state supreme court in a still more recent case, decided May 11, 1926. In this case a Maine corporation was the owner of the stock of a Wisconsin corporation. The latter corporation declared dividends which were credited to the Maine corporation. The plaintiffs in turn received dividends from the Maine corporation and sought to have deducted from their income tax assessment the amount of these dividends. The court held as follows:

"This case is ruled by the case of State ex rel Columbia Const. Co. vs. Tax Commission, 166 Wis. 369, 165 N. W .382. It was there held that dividends issued by a corporation stockholder, out of income derived from a corporation that had paid its income tax on its income, to its stockholder, in that case a corporation, were not exempt from taxation. The statute provides for no exemption in such cases and the courts can make none. The legal entity of corporations cannot be destroyed to relieve an apparent or real hardship. The Wisconsin and Maine corporations are in law as much separate entities as are A and B.

The effort to trace the funds or profits passing from one corporation to another and to claim that, since such profits have paid one income tax for a certain year, they should not pay another, is useless, because an income tax is not levied upon property, funds, or profits, but upon the right of an individual or corporation to receive income or profits. The same funds or property may constitute the income or profits of a dozen or more individuals during the same year."

Paine vs. City of Oshkosh, 208 N. W. 790.

It is therefore clear that the plaintiffs in error are entitled under the Wisconsin law to inquire only whether the dividends of the corporation came out of earnings or out of capital. This inquiry avails them nothing in this case. This is for the very apparent reason that even so much of the dividends as were made up out of the income of tax-exempt securities came out of earnings and not out of capital. These earnings were exempt, it is true, as to the corporations owning the securities, but they were nevertheless earnings, as distinguished from capital. Further, the exemption is personal to the corporation and is not available to the stockholder, as will be shown under a separate heading in this brief.

III.

UNDER THE DECISIONS OF THE SUPREME COURT OF WISCONSIN AND ALSO OF THE SUPREME COURT OF THE UNITED STATES THE INCOME FROM TAX EXEMPT SECURITIES IS EXEMPT FROM TAXATION AS TO THE CORPORATIONS WHICH OWN SUCH SECURITIES, BUT SUCH EXEMPTION DOES NOT ATTACH TO THE DIVIDENDS OF SAID CORPORATIONS AND BECOME AVAILABLE TO A STOCKHOLDER THEREOF.

The decedent of plaintiffs in error was a stockholder in three corporations, each of which was the owner of certain tax-exempt federal securities. These corporations each declared certain dividends to said decedent, some in stock and some in cash, and plaintiffs now contend that so much of said dividends as was derived by the corporations from the income of said exempt securities cannot be assessed to their decedent as income, but retains its character as an exemption even after it has passed out of the hands of the corporations which actually owned these securities.

This contention is contrary to the plain phraseology of the Wisconsin income tax law, ignores the legal distinction between a corporation and its stockholders, and is contrary to the decisions of the supreme court of Wisconsin and also of the Supreme Court of the United States.

Section 71.01 provides that there shall be a tax "on all income *received* * * by every person residing within the state * * *except as hereinafter exempted* * *."

Section 71.02 defines income to include dividends and profits and provides that the term "dividends" shall be held to mean "any distribution made by a corporation * * out of its earnings or profits accrued since January 1, 1911, and paid to its stockholders, whether in cash or in stock * * *."

Section 71.04, which deals with deductions allowed persons other than corporations, allows as deductions "dividends or interest in any corporation * * the income of which shall have been *assessed* under the provisions of this act * *."

It is clear that under the foregoing sections of the statutes, as well as under the entire income tax law, the decedent of plaintiffs in error "received" dividends, that such dividends constituted "income" within the meaning of the statute, and that he is liable to an income tax based thereon unless expressly exempted by the law.

We do not understand that plaintiffs in error contend that they are entitled to a deduction or exemption under any express provision of the income tax law. On the contrary, Exhibit A to the bill of complaint (pages 3 and 4 of the Transcript of Record) shows that the income accrued to the corporations from liberty bonds issued after January 1, 1911. Therefore the dividends were a "distribution made by a corporation * * out of its earnings or profits accrued since January 1, 1911, and paid to its stockholders, whether in cash or in stock of the corporation," within the meaning of section 71.02 (2)(b) of the Wisconsin statutes.

Neither does the income in question constitute a deduction under section 71.04 of the statutes. This section allows as deductions "dividends or interest in any corporation * * the income of which shall have been *assessed* under the provisions of this act * *." To constitute an assessment within the meaning of this statute there must be the assessment of a tax because of the existence of the fund as income. The

fact that earnings from the Federal securities were exempt to the corporations did not constitute an assessment within the meaning of the law.

> *State ex rel Sallie F. Moon Co. vs. Wis. Tax Comm.*, 166 Wis. 287;
> *State ex rel Columbia C. Co. vs. Tax Commission*, 166 Wis. 369.

The contention of plaintiffs in error likewise ignores the fact that a corporation is a separate and distinct legal entity from its stockholders. Under the income tax law the income of the one is entirely distinct from that of the other. Each is classified by section 71.02 as a "person", and section 71.01 requires that every person shall pay a tax on all income *received*. Manifestly, income received by a corporation is separate and distinct from income received by the stockholders. Bearing in mind that the corporation and its stockholders are distinct legal entities, it follows that an exemption allowed a corporation cannot be passed on and be made available to the stockholders unless expressly so provided.

This question is no longer open to argument either under the decisions of the state court or of this court.

The question was first presented to the Wisconsin supreme court in a case where there were three corporations involved, each in turn owning stock in the other. The first corporation paid an income tax on its entire income for the year. The second corporation, whose sole income consisted of dividends paid by the first corporation, was exempted from income tax because the first corporation had paid a tax upon its entire income. The third corporation likewise claimed an exemption on the ground that its income was received from the second corporation and that a tax had already been paid on such income. This claim for exemption was denied. The court disposed of the question under consideration in the following language:

"The claim is also made that the income in question should have been exempted because the Wisconsin Securities Company (the first corporation) had paid the tax on its income and because the income of the relator (the third corporation) in question was remotely derived therefrom. This claim is not tenable. The statute provides for no such exemption. The relator had no stock in the Securities Company and hence received no dividends from stock in a corporation whose income had already been assessed for income taxation."

State ex rel Columbia C. Co. vs. Tax Commission, 166 Wis. 369.

In a still more recent case (decided May 11, 1926) the plaintiffs were stockholders of a Maine corporation which owned the stock of a Wisconsin corporation and sought to have allowed as a deduction the dividends received by them from the Maine corporation based upon dividends in turn received by that corporation from the Wisconsin corporation. The supreme court of Wisconsin, after referring to the fact that no exemptions were provided in such cases, held as follows:

"The legal entity of corporations cannot be destroyed to relieve an apparent or real hardship. The Wisconsin and Maine corporations are in law as much separate entities as are A and B.

The effort to trace the funds or profits passing from one corporation to another and to claim that, since such profits have paid one income tax for a certain year, they should not pay another, is useless, because an income tax is not levied upon property, funds or profits, but upon the right of an individual or corporation to receive income or profits. The same funds or property may constitute the income or profits of a dozen or more individuals during the same year."

Paine vs. City of Oshkosh, 208 N. W. 790.

The same ruling has been made by the Supreme Court of the United States. This was in a case which arose in the State of Iowa on a petition seeking revision of an assessment of the shares of stock in a national bank. These shares were assessed to their several owners, the stockholders. The aggregate of the bank's capital, surplus and undivided earnings was taken as the value of the shares and from this the amount actually invested in real property was deducted. A proportionate part of the remaining sum was attributed to each share. Included in the bank's assets were various securities concededly exempt from state taxation by the laws of the United States. The bank sought to have the amount of these securities excluded from the assessment so as to work a proportionate decrease in the assessable value of the shares of stock. The Supreme Court of the United States, disallowing this deduction, held that the construction of the state tax law and its validity under the state constitution as given by the supreme court of the state was controlling; and that the state was not subjecting securities of the United States to state taxation in disregard of exemptions arising out of the laws of the United States. The court uses the following language:

> "The next contention—that the statute subjects securities of the United States to taxation contrary to exempting laws of the United States, in that it requires that the assessment be based on the aggregate of the capital, surplus, and undivided earnings, without any deduction or allowance on account of the investment in such securities—confuses the shares which are the property of the stockholders, with the corporate assets, which are the property of the bank. It is quite true that the states may not tax such securities, but equally true that they may tax the shares in a corporation to their owners, the stockholders, although the corporate assets consist largely of such securities, and that in assessing the shares it is not necessary to deduct what is invested in the securities. The difference turns on the distinction between the corporate assets and the

Sec. 71.03. Every corporation * * * shall be allowed to make from its gross income the following deductions:

* * * * * * *

(5) Dividends or income received within the year from stocks or interest in any corporation * * * the income of which shall have been assessed under the provisions of this act; provided that when only part of the income of the corporation * * * from which such dividend or income was received shall have been assessed under this act, only a corresponding part of such dividend or income shall be deducted; * * *.

Sec. 71.04. Persons other than corporations, joint stock companies or associations in reporting incomes for purposes of taxation shall be allowed the following deductions:

* * * * * * *

(4) Dividends or incomes received by any person from stocks or interest in any corporation * * * the income of which shall have been assessed under the provisions of this act; provided that when only part of the income of any corporation * * * shall have been assessed under this act only a corresponding part of the dividends or income received therefrom shall be deducted, * * *.

Sec. 71.05.—(1) There shall be exempt from taxation under this chapter, income as follows, to-wit:

* * * * * * *

(e) Dividends received from state banks, national banks, mutual savings banks and trust companies subject to taxation by this state."

Sec. 71.09.—(1) The state tax commission and the assessors of incomes shall annually on the first day of January or as soon thereafter as practicable, proceed to assess as hereinafter provided every income received during the preceding calendar year liable to taxation under the provisions of this chapter."

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SUMMARY OF ARGUMENT.

I.

The only question here presented is whether dividends of corporations, to the extent to which they were earned by such corporations out of the income of tax-exempt Federal securities, may legally be assessed to the stockholders as income under the constitution and laws of Wisconsin.

II.

The tax is valid under the constitution and laws of Wisconsin.

III.

Under the decisions of the supreme court of Wisconsin and also of the Supreme Court of the United States the income from tax-exempt securities is exempt from taxation as to the corporations which own such securities, but such exemption does not attach to the dividends of said corporations and become available to a stockholder thereof.

IV.

The construction of the supreme court of Wisconsin given to the constitutional provision and to the statutes enacted pursuant thereto is controlling in this court.

V.

The tax is not in conflict with the due process clause of the Fourteenth Amendment.

MISSING

shares,—the one belonging to the corporation as an artificial entity and the other to the stockholders. As respects national banks, the rule is the same as with corporations in general."

Des Moines National Bank vs. Fairweather,
263 U. S. 103, 68 L.Ed. 191.

It is therefore clear that both the supreme court of Wisconsin and the Supreme Court of the United States are in accord on the proposition that exemptions allowable to a corporation owning Federal securities are not also available to a stockholder. In fact, the *Des Moines National Bank case*, just above referred to, might be cited as a complete answer to all the contentions of the plaintiffs in error.

IV.

THE CONSTRUCTION OF THE SUPREME COURT OF WISCONSIN GIVEN TO THE CONSTITUTIONAL PROVISION AND TO THE STATUTES ENACTED PURSUANT THERETO IS CONTROLLING IN THIS COURT.

We have previously called attention in this brief to the decisions of the supreme court of Wisconsin wherein the validity of the tax in question is upheld in all particulars. The proper construction of the state statute and its validity under the state constitution are questions of local law, the decision of which by the highest court of the state is controlling.

Des Moines National Bank vs. Fairweather,
263 U. S. 103, 68 L. ed. 191 (and cases cited).

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V.

THE TAX IS NOT IN CONFLICT WITH THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT.

It is argued by plaintiffs in error that so far as stock dividends are involved, to the extent that they have been declared out of interest accruing from Federal securities, the imposition of the tax in question contravenes the due process clause of the Fourteenth Amendment. This argument is based upon the contention that a stock dividend is in effect a tax upon the property of the corporation itself.

It is perhaps sufficient answer to this argument that a corporation is a distinct and separate legal entity from its stockholders; that a tax upon a stockholder is separate and distinct in contemplation of law from a tax upon the corporation; that an exemption from taxation given to a corporation does not pass to and become also available to a stockholder thereof even though the latter derives his income from dividends declared out of exempt earnings of the corporation; that under the ruling of the state court, which is controlling in this, stock dividends constitute income to the stockholder entirely separate and distinct within the meaning of the income tax law from the income of the corporation out of which these dividends were declared.

We also call the attention of the court to the fact that no claim is made in this case that the income tax law of Wisconsin does not in matters of procedure amply protect the rights of taxpaying stockholders, or that the procedure outlined by the statutes for the assessment, levying or collection of the tax was not followed, or that the statutes do not afford proper notice or due opportunity for hearing or in any other procedural way violate the due process clause of the Fourteenth Amendment. On the contrary, it appears from the complaint itself, which in that respect is stipulated

to be the fact, that the decedent of plaintiffs in error was not only afforded ample opportunity for hearing but that as a matter of fact he actually availed himself of all the machinery of the law provided for that purpose.

It is elementary that the due process of law clause contains no specific limitation upon the power of the states to impose taxes and that outside of procedural matters relating to notice and hearing and the like this clause has very limited application to tax statutes. This general rule and the supporting authorities are well set forth in *Cooley on Taxation* where the following language is used:

> "It will be observed that the due process of law clause contains no specific limitation upon the power of the states to impose taxes. 'Due process of law' is not defined by the federal or state constitution, and the courts have deemed it impossible to frame a definition covering all cases. The term is synonymous with 'law of the land.' A strict interpretation of the words 'due process of law,' it has been said 'would limit their effect to matters of procedure rather than of substantive law,' but while 'the majority of the cases on the subject do undoubtedly refer to matters of procedure, classifying notice and hearing as subjects of procedure,' yet 'these rights as to procedure which attain to the dignity of constitutional rights are so substantial that the distinction between them and real substantive rights is very shadowy, to say the least.' What would be due process if done under the taxing power is not necessarily due process if done under some other power. In tax cases, especially those carried to the Supreme Court of the United States, it is customary, it seems, to add to other constitutional objections, for good measure, the contention that the tax law violates the due process of law provision. In nearly every case, however, except those cases where notice and hearing are involved, the court has merely rejected the contention without discussion. The result is that hundreds of cases are to be found in the digests holding that a particular tax statute, as to substantive rights, does not violate the due process clause. These decisions are

of little or no value. In fact outside of decisions relating to notice and hearing and the like, the particulars in which tax statutes may violate the due process clause are very limited. Property taken in the lawful exercise of the taxing power is not taken without due process of law. In the exercise of the taxing power, due process does not require that the property subject to the tax or the amount of tax to be raised should be determined by judicial inquiry, and a notice and hearing as to the amount of the tax and the manner in which it shall be apportioned are generally not necessary to due process of law. A tax does not violate the due process clause because it operates unjustly nor because it constitutes double taxation; and the motives or purpose of the taxing power cannot be inquired into, to invalidate a tax as a violation of the due process clause. If a tax is within the power of the legislature, there is no violation of the due process clause because of the results which may or will arise from the tax."

Cooley on Taxation (4th ed.), page 330.

Again the same authority says (page 338):

"A state has a right to devise its own system of taxation free from federal interference.

From this amendment the federal courts derive no general jurisdiction to prevent, or to relieve from, oppression under state laws, or to correct errors and mistakes of detail in state administration. Errors in the administration of a tax stature, not jurisdictional in character, will not justify the Federal Supreme Court in holding, on writ of error, that the state has deprived or is about to deprive the complaining party of his property without due process of law. The Fourteenth Amendment of the Federal Constitution, so far as it declares that no state shall deprive any person of property without due process of law, does not limit the taxing power of the states, whatever the methods devised for the purposes of taxation, unless such methods, by their necessary operation, are inconsistent with the fundamental principles embraced by the requirements of due process of law."

The question whether the income tax law of Wisconsin is in conflict with the Fourteenth Amendment was exhaustively discussed by the late Chief Justice Winslow in the case which upheld the constitutionality of the original Wisconsin income tax law. The Federal cases cited by the opponents of the law were analyzed and it was held that the law was not in conflict with the amendment.

Income Tax Cases, 148 Wis. 456, 506.

It will not be necessary to refer at length to the cases in this court governing this proposition. The court is familiar with them. We will, however, quote from two cases which seem to have particular application to the exact point under discussion. In these cases the rule is laid down as follows:

> "There is no general supervision on the part of the nation over state taxation, and in respect to the latter the state has, speaking generally, the freedom of a sovereign both as to objects and methods. It was well said by Judge Wanty, delivering the opinion of the circuit court in this case (p. 232):
>
> 'There can at this time be no question, after the frequent and uniform expressions of the federal supreme court, that it was not designed by the XIVth amendment to the constitution to prevent a state from changing its system of taxation in all proper and reasonable ways, nor to compel the states to adopt an ironclad rule of equality, to prevent the classification of property for purposes of taxation, or the imposition of different rates upon different classes. It is enough that there is no discrimination in favor of one as against another of the same class, and the method for the assessment and collection of the tax is not inconsistent with natural justice.'"

Mich. Cent. R. Co. vs. Powers, 201 U. S. 245, beginning at page 292.

And again:

> "The taxing power of the states is primarily vested in their legislatures, deriving their authority from the people. When a state legislature acts without the scope of its authority it is responsible to the people, and their right to change the agents to whom they have entrusted the power is ordinarily deemed a sufficient check upon its abuse. When the constituted authority of the state undertakes to exert the taxing power, and the question of the validity of its action is brought before this court, every presumption in its favor is indulged, and only clear and demonstrated usurpation of power will authorize judicial interference with legislative action."

Green vs. Frazier, 253 U. S. 233, 239.

IN CONCLUSION.

In conclusion we submit:

1. That the tax in question is valid under the constitution and laws of Wisconsin.

2. That the ruling of the state court construing the constitutional provision and the statutes to authorize the tax is controlling in this court.

3. That the exemption attaching to the interest from the tax-exempt securities in the hands of the corporations does not pass and become available to stockholders receiving dividends from such corporations.

4. That this case is ruled, as to all the above mentioned propositions, by *Des Moines National Bank vs. Fairweather,* 263 U. S. 103.

5. That the tax does not contravene the Fourteenth Amendment.

For the foregoing reasons it is therefore respectfully submitted that the judgment of the trial court should be affirmed.

Respectfully submitted,

JOHN M. NIVEN,
WALTER J. MATTISON,

Counsel for Defendant in Error.